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NO. 20818

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

REGINO MARTIN ESPINO,

Appellant,

vs.

OCEAN CARGO LINE, LTD.,
etc., et al.,

Appellees.

APPELLANT'S OPENING BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

MARGOLIS and McTERNAN
By: BEN MARGOLIS
3175 West Sixth Street
Los Angeles, California 90005

Attorneys for Appellant

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Los Angeles, California 90005

Attorneys for Appellant

TOPICAL INDEX

		Page
Table of Authorities		ii
STATEMENT OF PLEADINGS AND JURISDICTIONAL FACTS		1
STATEMENT OF THE CASE		2
QUESTIONS PRESENTED		5
I	THE TRIAL COURT ERRED IN SUSTAINING RESPONDENT'S EXCEPTION WHERE LIBELANT HAD SET FORTH FACTS IN HIS LIBEL WHICH ALLEGED BOTH EXCUSABLE DELAY AND LACK OF PREJUDICE TO RESPONDENT.	6
II	NOTWITHSTANDING THE PRINCIPLE THAT AN AFFIDAVIT MAY NOT BE CONSIDERED ON AN EXCEPTION TO A LIBEL, RESPONDENT FAILED TO ALLEGE SUFFICIENT FACTS TO WARRANT A DISMISSAL OF THE LIBEL.	8
III	THE COURT ERRED IN DISMISSING THE LIBEL IN THAT SAID LIBEL WAS NOT BARRED BY LACHES.	9
IV	THE COURT ERRED IN DENYING LIBELANT'S MOTION TO FILE A SECOND AMENDED LIBEL IN THAT THE PROPOSED SECOND LIBEL STATED A CLAIM UPON WHICH RELIEF COULD BE GRANTED.	16
CONCLUSION		18
CERTIFICATE		19

TABLE OF AUTHORITIES

Cases	Page
Abbott v. United States, 207 F. Supp. 468 (U. S. D. C. N. Y.)	7
Akers v. State Marine Lines, Inc., 344 F. 2d 217 (5th Cir.)	6
Brown v. Kayler, 273 F. 2d 588 (9th Cir. 1959)	4, 13, 14
Cities Service Oil Co. v. Puerto Rico Lighterage Co., 305 F. 2d 170 (1st Cir. 1962)	6, 15
Claussen v. Mene Grande Oil Company, 275 F. 2d 108 (3rd Cir.)	6
Cleary Brothers, Inc. v. Luria Steel and Trading Corp., 198 F. Supp. 567 (U. S. D. C. N. Y.)	8
Compagnie Generale Trans. v. City of New York, 114 F. Supp. 252 (U. S. D. C. N. Y.)	8
Costello v. United States, 365 U. S. 265	6
Dennis v. Slyfield, 117 Fed. 474 (6th Cir.)	6
Fidelity and Casualty Company of New York v. C/B Mr. Kim, 345 F. 2d 45 (5th Cir.)	6
Flowers v. Savannah Machine & Foundry Co., 310 F. 2d 135 (5th Cir. 1962)	10
Gardner v. Panama Railroad, 342 U. S. 29	14, 15
Giddens v. Isbrandtsen Co., 355 F. 2d 125 (4th Cir. 1966)	10, 12
Gutierrez v. Waterman Steamship Corp., 373 U. S. 206	16
Hernandez v. The S. S. Flying Arrow, 181 F. Supp. 951 (U. S. D. C. N. Y.)	8
Intercontinental Transportation Co. v. Tug Switcher No. 2, 221 F. Supp. 748 (U. S. D. C. Tex.)	16

	Page
F. Jacobus Transp. Co. v. Gallagher Bros. Sand and G. Corp., 161 F. Supp. 507 (U.S.D.C. N.Y.)	7
McAllister v. Magnolia Petroleum Co., 357 U.S. 221	13
McDaniel v. Gulf & South American Steamship Co., 228 F.2d 189 (5th Cir.)	7
The S. S. Nea Hellis, 116 F.2d 803 (2nd Cir.)	6
Smigiel v. Compagnie De Transports Oceaniques, 185 F. Supp. 328 (U.S.D.C. Penn.)	15
The Sydfold, 86 F.2d 611 (2nd Cir.)	8
Walker v. Benjamin Foster Co., Inc., 92 F. Supp. 402 (U.S.D.C. Penn.)	7
Williams v. Moran, Proctor, Mueser & Rutledge, 205 F. Supp. 208 (U.S.D.C. N.Y.)	7
Wnuczwnski v. Argonaut Navigation Company, 130 F. Supp. 439 (U.S.D.C. Md.)	8

Statutes

Title 28, United States Code, §1291	2
Title 28, United States Code, §1332	2
Title 28, United States Code, §1333	2
Title 46, United States Code, §688 (Jones Act)	10, 13

Rules

Federal Rules of Civil Procedure:

Rule 73	2

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APPELLANT'S OPENING BRIEF

STATEMENT OF PLEADINGS AND JURISDICTIONAL FACTS

This litigation arises out of an injury suffered on February 29, 1964 by appellant, Regino Martin Espino (hereinafter called libelant), a shipscaler, while he was assisting in the lowering of a cargo net into the hold of the vessel SS Atlantic Gladiator, owned by the appellee, Ocean Cargo Line, Ltd. (hereinafter called respondent). The action in the District Court was commenced on June 3, 1965 by the filing of a libel in personam in admiralty, wherein libelant set out separate causes of action for negligence and unseaworthiness (C. 2-7). 1/ Said libel was amended on

---

1/ "C" refers to Clerk's Transcript.

August 13, 1965 (C. 8-13). On August 26, 1965, respondent filed an exception to the libel, wherein it was averred that libelant's claim was barred by laches (C. 17). An order sustaining the exception was filed by the trial court on September 13, 1965 (C. 28-1 - 28-2). Libelant's motion for leave to file a second amended libel (C. 29-39) was denied by the court on October 6, 1965 (C. 46-47). On January 5, 1966, the court entered a judgment of dismissal on the ground that the libel was barred by laches (C. 48-49). Libelant filed his notice of appeal on January 14, 1966 (C. 50).

The jurisdiction of the District Court is based on the admiralty and maritime provisions of 28 U. S. C. 1333. Furthermore, there is diversity of citizenship within the meaning of 28 U. S. C. 1332. The jurisdiction of this court to review the judgment below rests upon 28 U. S. C. 1291, notice of appeal having been filed within the time provided by Rule 73, Federal Rules of Civil Procedure.

STATEMENT OF THE CASE

Libelant, Regino Martin Espino, filed his initial pleading in this action one year, three months and five days after the date of the action in which he was injured. In the libel in personam filed on said date (C. 2-7), and in the amended libel filed August 13, 1965 (C. 8-13), libelant alleged that:

> "Libelant's suit is not barred by laches in that libelant was born in Cuba and cannot speak, read or write the English language, is uneducated and

understood that his rights were limited to payments under the Longshoremen's and Harbor Workers' Act. At no time was he told by his employer or the Deputy Commissioner of Labor that he had any rights against the shipowners herein. Members of the crew of the vessel were present at the scene of the accident and were aware of it, and were in fact operating and controlling the winch and boom involved in the accident as above set forth, thus giving the officers and members of the crew of the vessel immediate knowledge that a serious injury to a worker had occurred. Respondents, and each of them, were thus put on notice of the accident and have not been prejudiced by any delay in the filing of this action by libelant." (C. 5, 11.)

In response, respondent, Ocean Cargo Line, filed an Exception to Libel (C. 17) in which it was alleged that:

> ". . . the facts averred in the libel show that libelant's claim is barred by laches resulting from unreasonable delay, all to the prejudice of respondent Ocean Cargo Line, Ltd. herein." (C. 17.)

Respondent's exception was supported by an affidavit (C. 18-25) wherein respondent's attorney stated:

> "The S. S. Atlantic Gladiator is a vessel which was owned by Ocean Cargo Line, Ltd., a member of

the West of England Steamship Owners Protection and Indemnity Association. On July 19, 1965, I wrote to the West of England Association with a copy to Ocean Cargo Line (S. Livanos-Hellas S. A., Piraeus, Greece) requesting information regarding the casualty, including information with respect to availability of witnesses from among the ship's crew; the vessel's present whereabouts and current schedule; etc. On August 3, 1965, owners replied that they were unable to supply this information 'in view of the fact that this vessel is no longer owned by Ocean Cargo Line, Ltd., and the crew have long since scattered to various countries.' " (C. 18-20.)

Said exception was sustained by the trial court on the ground that the claim was barred by laches, citing Brown v. Kayler, 273 F. 2d 588 (9th Cir. 1959) (C. 28-1).

Libelant thereupon moved for leave to file a second amended libel (C. 29-39), wherein libelant added the following allegation pertaining to laches:

> "As a direct result of libelant's inability to speak, read or write the English language, his lack of education and his misunderstanding of his rights, as aforesaid, libelant did not consult an attorney until May 13, 1965, fourteen and one-half months after the date of the accident herein." (C. 36.)

The motion to file a second amended libel was denied by the trial court (C. 46-47). The judgment of dismissal was entered on January 5, 1966 on the ground that the libel was barred by laches (C. 48).

QUESTIONS PRESENTED

1. Whether the court erred in sustaining respondent's exception to libel in that an exception in admiralty is analogous to a demurrer and cannot be sustained on a claim of laches when facts are set out in the libel which allege both excusable delay and lack of prejudice to respondent.

2. Whether the court erred in considering respondent's affidavit in support of the exception to the libel in that an affidavit may not properly be considered on an exception to a libel in an admiralty proceeding.

3. Whether the court erred in denying libelant's motion to file a second amended libel in that the proposed second amended libel stated a claim upon which relief could be granted.

4. Whether the court erred in dismissing the libel in that said libel was not barred by laches.

I

THE TRIAL COURT ERRED IN SUSTAINING RESPONDENT"S EXCEPTION WHERE LIBELANT HAD SET FORTH FACTS IN HIS LIBEL WHICH ALLEGED BOTH EXCUSABLE DELAY AND LACK OF PREJUDICE TO RESPONDENT.

In admiralty, an exception serves the function of a demurrer in common law or equity pleadings; it should not be sustained if any cause of action is well pleaded in the libel. (Dennis v. Slyfield (6th Cir.), 117 Fed. 474, 479, 480 and The S.S. Nea Hellis (2nd Cir.), 116 F.2d 803, 805.)

A suit in admiralty is barred by laches only when there has been both unreasonable delay in the filing of the libel and consequent prejudice to the party against whom the suit is brought. (Costello v. United States, 365 U.S. 265; Akers v. State Marine Lines, Inc. (5th Cir.), 344 F.2d 217; Cities Service Oil Co. v. Puerto Rico Lighterage Co. (1st Cir.), 305 F.2d 170; Fidelity and Casualty Company of New York v. C/B Mr. Kim (5th Cir.), 345 F.2d 45, 51 et seq.; Claussen v. Mene Grande Oil Company, C.A. (3rd Cir.), 275 F.2d 108, 113.)

In the twelfth paragraph of libelant's libel (C.5) and first amended libel (C.11) it was alleged that the suit was not barred by laches by virtue of the fact that libelant was foreign born, could not speak, read or write the English language and was thereby ignorant of his rights, and also by virtue of the fact that the respondent had notice of the accident and was not prejudiced by the delay.

Accepting the allegations made by libelant as true, respondent's exception to libel is not well taken. Libelant has pleaded facts which excuse his delay and show that respondent was not unduly prejudiced in this matter. A court will not, on an exception to a libel, determine issues of fact. The allegations of fact contained in the libel are accepted as true on exceptions. (McDaniel v. Gulf & South American Steamship Co. (5th Cir.), 228 F.2d 189; Walker v. Benjamin Foster Co., Inc. (U.S.D.C. Penn.), 92 F. Supp. 402; F. Jacobus Transp. Co. v. Gallagher Bros. Sand and G. Corp. (U.S.D.C. N.Y.), 161 F. Supp. 507, 512; Williams v. Moran, Proctor, Mueser & Rutledge (U.S.D.C. N.Y.), 205 F. Supp. 208, 212; Abbott v. United States (U.S.D.C. N.Y.), 207 F. Supp. 468, 471.)

In McDaniel v. Gulf & South American Steamship Co., supra, libelant had pleaded certain facts which tended to excuse his delay and averred that respondent was not prejudiced by such delay. The court held that under such circumstances laches does not appear upon the face of a libel and that the libelant should have been permitted to meet the defense of laches in a hearing on the merits. Similarly, in Walker v. Benjamin Foster Co., Inc., supra, the court pointed out that laches consists of both inexcusable delay plus prejudice to the adverse party resulting from the delay, and that where the libel sought to plead facts negativing laches or tolling the statute of limitations and it did not appear that the allegation of no prejudice to respondent was inadequate as a matter of law, exceptions would be overruled, since the appropriate time to

determine whether libelant could overcome the presumption of laches would not arise until a hearing had been held after an answer. Libelant herein has pleaded facts which, if accepted as true, excuse delay and, more important, establish that respondent was not prejudiced by such delay.

II

NOTWITHSTANDING THE PRINCIPLE THAT AN AFFIDAVIT MAY NOT BE CONSIDERED ON AN EXCEPTION TO A LIBEL, RESPONDENT FAILED TO ALLEGE SUFFICIENT FACTS TO WARRANT A DISMISSAL OF THE LIBEL.

In support of its exception to the libel, respondent herein filed an "Affidavit In Support Of Exceptions to Libel". It is a well established principle of law that affidavits may not be properly considered on an exception to a libel in an admiralty proceeding. (The Sydfold (2nd Cir.), 86 F. 2d 611; Hernandez v. The SS Flying Arrow (U. S. D. C. N. Y.), 181 F. Supp. 951; Cleary Brothers, Inc. v. Luria Steel and Trading Corp. (U. S. D. C. N. Y.), 198 F. Supp. 567; Wnuczwnski v. Argonaut Navigation Company (U. S. D. C. Md.), 130 F. Supp. 439, 441; Compagnie Generale Trans. v. City of New York (U. S. D. C. N. Y.), 114 F. Supp. 252.)

Notwithstanding this principle of law, respondent's affidavit does not allege sufficient facts to warrant a dismissal of the libel herein. In support of its position that it has been unduly prejudiced by the delay in this matter, respondent alleges that it has not been able to prepare a defense to the lawsuit because the vessel has been

sold and the crew members are no longer available (C. 18-20). Nowhere in the respondent's affidavit is there any indication as to when the vessel S. S. Atlantic Gladiator was sold, nor is there any denial that the owners of said vessel were put on notice of the accident at or about the date of its occurrence. Certainly, if the vessel S. S. Atlantic Gladiator was sold prior to the running of the applicable California statute of limitations, it could not be alleged that the late filing of libelant's libel herein was prejudicial in any way to respondents. If, in fact, the vessel was sold within one year after the accident occurred, respondent is in no different position today than it would have been had libelant filed his action subsequent to the sale of the vessel but prior to the running of the statute of limitations.

Respondent's affidavit raised certain issues of fact which could not be determined at the hearing on the exception to the libel. Libelant should have been afforded an opportunity to inquire into the factual assertions of the affidavit, utilizing pretrial discovery procedures and cross-examination techniques at the trial on the merits of the case.

III

THE COURT ERRED IN DISMISSING THE LIBEL IN THAT SAID LIBEL WAS NOT BARRED BY LACHES.

The instant libel was filed approximately three months and five days in excess of one year from the occurrence of the accident.

Applying the analogy of the California one year statute of limitations for personal injury actions, the District Court dismissed for laches.

Recent decisions in the Fourth and Fifth Circuits raise grave doubts concerning the propriety of applying the analogy of the state's statute of limitations for personal injury actions to maritime negligence or unseaworthiness actions in admiralty. In Flowers v. Savannah Machine & Foundry Co. (5th Cir. 1962), 310 F. 2d 135 and Giddens v. Isbrandtsen Co. (4th Cir. 1966), 355 F. 2d 125, the courts have held that the Jones Act three year period of limitations (46 U. S. C. 688) should be substituted for the State period as the analogous reference guide. The court in the Flowers case commented at page 138:

> ". . . one thing is very, very clear: local law is now completely irrelevant to substantive rights concerning a maritime injury at least short of death. The standing of a transitory shore-based worker as a vicarious seaman and the nature of the duty owed are established as federal maritime law. . . . So much so is this that contributory negligence and similar defenses which would bar all recovery had the identical occurrence taken place a few feet away on the dock are rejected in favor of the maritime notion of comparative fault. . . .
>
> "What is left for local law? There is nothing left save an occasional use as a reference guide in determining whether the maritime principle of laches

bars the suit. And even here it is wholly fortuitous depending on where the suit is brought--whether in the State in which the accident occurred, or elsewhere-- and on the choice-of-law rules, statutory or judge-made, of the forum state. As we have said, certitude and ease in the adjudication of claims for injury to workers in this ambiguous, amphibious area is too much to hope for. But the continued reliance as a matter of judge-made law on local statute of limitations as the reference guide does more than create administrative problems of great difficulty. In an area now clearly one for federal supremacy in substantive rights, it produces variable results depending upon the wholly fortuitous, but otherwise irrelevant, local limitation statute. This is itself to impede that essential uniformity of the admiralty which is at the heart of all of this troublesome litigation. . . .

"Since the District Court used the Georgia two-year period as the guideline, and we now hold that for this type of case, the Jones Act three-year period is to be used by analogy, the cause must be reversed and remanded for further and other consistent proceedings."

Similarly, in the Giddens case, supra, the court commented at page 127:

"The Virginia statute, we think, is not so closely related to the question as to be a significant factor. Giddens does not sue on a cause of action afforded by Virginia common law or statute. His suit is pitched exclusively on maritime law, as granting him recourse against the shipowner. While a longshoreman is not a crewman in all considerations, he is afforded comparable protection when performing the traditional duties of the crewman. (Citing cases.) We do not mean to say that 'state statutes of limitations are immaterial in determining whether laches is a bar,' . . .; we simply say that Virginia's law should not have the decisive influence accorded it by the District Court.

"On the other hand, the limitation in the Jones Act - 3 years - is a more logical and acceptable polestar. It relates to personal injuries on navigable waters. Presumably it was adopted with seamen's circumstances in mind. On the other hand, the State statute comprehends many other and more varied concerns, landside rather than offshore. Also the Jones Act is of national application, thus providing a uniform criterion wherever in the United States maritime responsibilities are to be enforced. Force

> is lent to this argument by recalling that the 3 years fixed in the Federal statute represents the consensus of Congress, the final authority on remedies in admiralty, as to what is a fair opportunity for suit."

The aforementioned opinions are supported in part by a decision of the United States Supreme Court in McAllister v. Magnolia Petroleum Co., 357 U.S. 221. The McAllister case itself is limited to suits brought by seamen combining Jones Act and unseaworthiness counts and holds only that in such combined suits no shorter period of limitations can be applied than the Jones Act three-year period. Mr. Justice Brennan, concurring, suggests that the Jones Act period should be applied in all unseaworthiness cases. Mr. Justice Brennan states:

> "Just as equity follows the law in applying, as a rough measure of limitations, the period which would bar a similar action at law, . . . I think that a maritime cause of action for unseaworthiness could be measured by the analogous action at law for negligence under the Jones Act, 46 USC 688." (357 U.S. at page 229.)

Whichever statutory period is used as a reference point, libelant alleged sufficient facts in the libel to establish both excusable delay and lack of prejudice to respondent. In Brown v. Kayler (9th Cir. 1959), 273 F.2d 588, cited by the trial court in its order sustaining the exception (C. 28-1), the court considered only the

matter of whether libelant had alleged sufficient facts in his libel which would constitute a valid excuse for the delay and thereby render the application of the doctrine of laches inequitable. Libelant failed to allege any facts which would show that the respondent was not prejudiced by the delay. The fact situation in the instant case is distinguishable from the Brown case in that the libelant herein has alleged that members of the crew of the vessel were present at the scene of the accident, were aware of it, and were operating the equipment involved in the accident, thereby giving immediate notice to the respondent that an accident had occurred and negativing any presumption of prejudice.

Further, in the Brown case the delay was caused in part by errors committed by counsel in failing to file the action within the applicable statute of limitations' period. Although it was alleged that the libelant in the Brown case was an Indian unfamiliar with legal matters, there was no allegation that he could not speak or read the English language and thus be unable to communicate with others concerning his legal rights. In the instant case, libelant did not consult an attorney until after the applicable statute of limitations had run and was handicapped by a lack of ability to speak, read or write the English language.

In Gardner v. Panama Railroad, 342 U. S. 29, the Supreme Court of the United States held that "Though the existence of laches is a question primarily addressed to the discretion of the trial court, the matter should not be determined merely by a reference to and a mechanical application of the statute of limitations. The

equities of the parties must be considered as well. Where there has been no inexcusable delay in seeking a remedy and where no prejudice to the defendant has ensued from the mere passage of time, there should be no bar to relief." (342 U.S. at pages 30-31).

In Smigiel v. Compagnie De Transports Oceaniques (U.S. D.C. Penn.), 185 F. Supp. 328 a fact situation appeared which was almost identical to libelant's case herein. In the Smigiel case the libelant, a longshoreman, was born in Poland and had a limited comprehension of the English language. He was basically uneducated and was given to understand that his rights were limited to payments under the Longshoremen and Harbor Workers' Act. At no time was he told by the Deputy Commissioner of Labor that he had any rights against the shipowner. Members of the ship's crew were present at the scene of the accident, immediately after its occurrence, and thus the officers and members of the crew of the vessel had immediate knowledge that a serious injury to a longshoreman had occurred. The court ordered the exception to the libel dismissed on condition that the trial judge was convinced that the respondent, through its authorized agents, had knowledge of the accident at or about the time of its occurrence. It is of some significance that the suit in the Smigiel case was brought four years and four months after the accident, whereas libelant herein filed his suit one year and three months after the date of his accident.

See also:

Cities Service Oil Co. v. Puerto Rico Lighterage Co. (1st Cir. 1962), 305 F.2d 170;

Intercontinental Transportation Co. v. Tug Switcher No. 2 (U.S.D.C. Tex.), 221 F.Supp. 748.

Even assuming the delay in filing was inexcusable, the requirement remains that prejudice therefrom must also be shown or be presumable before the bar of laches will validly arise. The United States Supreme Court has held decisively that prejudice is the sine qua non of laches, even where the delay exceeds the analogous statute of limitations period and is legally inexcusable. In Gutierrez v. Waterman Steamship Corp., 373 U.S. 206, the court stated at page 215:

> "The test of laches is prejudice to the other party. Gardner v. Panama R. Co., 342 U.S. 29-31, 96 L.ed. 31, 36, 72 S.Ct. 12; Cities Service Oil Co. v. Puerto Rico Lighterage Co., 305 F.2d 170, 171 (C.A. 1st Cir.) (both unreasonable delay and consequent prejudice) . . . ."

IV

THE COURT ERRED IN DENYING LIBELANT'S MOTION TO FILE A SECOND AMENDED LIBEL IN THAT THE PROPOSED SECOND LIBEL STATED A CLAIM UPON WHICH RELIEF COULD BE GRANTED.

In libelant's proposed second amended libel, the following statement was added relative to the reasons for the delay in filing said libel:

> "As a direct result of libelant's inability to

speak, read or write the English language, his lack of education and his misunderstanding of his rights, as aforesaid, libelant did not consult an attorney until May 13, 1965, fourteen and one-half months after the date of the accident herein." (C. 36.)

The aforesaid statement added weight to libelant's assertion that the delay in filing the libel was excusable. This fact, together with the repeated allegations concerning lack of prejudice to respondent, was sufficient to state a claim upon which relief could be granted. The court compounded its error in denying libelant's motion to file said second amended libel.

CONCLUSION

From the matters alleged in the libels filed by libelant, the authorities, and the law, it is respectfully urged that the trial court erred in:

1. Sustaining the exception where libelant set out facts in his libel which alleged both excusable delay and lack of prejudice to respondent.

2. Considering an affidavit in support of the exception.

3. Dismissing the libel on the ground that said libel was barred by laches.

4. Denying libelant's motion to file a second amended libel which alleged both excusable delay and lack of prejudice to respondent.

Respectfully submitted,

MARGOLIS and McTERNAN

By: BEN MARGOLIS

Attorneys for Appellant.

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ William G. Smith

WILLIAM G. SMITH

No. 20818

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

REGINO MARTIN ESPINO,

Appellant,

vs.

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Appellees.

Appeal From the United States District Court for the Southern District of California, Central Division.

APPELLEE'S BRIEF.

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WM. B. LUCK, CLERK

McCUTCHEN, BLACK, VERLEGER & SHEA,
HOWARD J. PRIVETT,
WINCHESTER COOLEY III,
615 South Flower Street,
Suite 1111,
Los Angeles, Calif. 90017,
Attorneys for Appellee.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

TOPICAL INDEX

Page

Jurisdictional statement 1

Statement of the case 1

Question presented 5

Prefatory statement 5

Summary of argument 6

Argument 8

I.

The District Court was privileged to consider respondent's affidavit 8

II.

The Trial Court did not abuse its discretion in dismissing for laches 10

A. Preliminary statement 10

B. Appellant failed to allege facts excusing the delay 11

C. Appellant failed to allege facts negativing prejudice to respondent 15

1. The undisputed facts set forth in the affidavit establish clear prejudice to respondent 15

2. The presumption of prejudice which results from untimely filing is alone sufficient to bar appellant's action 16

III.

The California statute of limitations is the proper standard of guidance 20

Conclusion 28

Appendix. Order Declining Jurisdiction ....App. p. 1

TABLE OF AUTHORITIES CITED

Cases — Page

Addison v. Huron Stevedoring Corp., 96 Fed. Supp. 142 20

American Universal Insurance Co. v. Dykhouse, 326 F. 2d 694 6

Borselli v. United States, 74 Fed. Supp. 822 23

Brown v. Kayler, 273 F. 2d 588 .... 10, 12, 13, 14, 20, 21

Cities Service Oil Co. v. Puerto Rico Lighterage Company, 305 F. 2d 170 17

Claussen v. Mene Grande Oil Co., 275 F. 2d 108 .. 18

Cleary Brothers, Inc. v. Luria Steel and Trading Corp., 198 Fed. Supp. 567 .... 17, 26

Czaplicki v. S.S. Hoegh Silvercloud, 351 U.S. 525 .... 10, 21

Dawson v. Fernley & Eger, 196 Fed. Supp. 816 23

Dryden v. Ocean Accident & Guarantee Corp. Ltd., 138 F. 2d 291 23

Erie R.R. v. Tompkins, 304 U.S. 64 27

Fidelity Casualty Company of New York v. C/B Mr. Kim, 345 F. 2d 45 18

Flowers v. Savannah Machine & Foundry Co., 310 F. 2d 135 .... 21, 22, 25, 26, 27, 28

Foorman v. Myers, 1 Cal. App. 2d 719 20

Gardner v. Panama R. Co., 342 U.S. 29 ......6, 10, 19

Glidden v. Isbrandtsen Co., 355 F. 2d 125 21

Goodwyn v. Dredge Ginger Ann, 342 F. 2d 197 6

Guaranty Trust Company v. York, 326 U.S. 99 27

Guerrido v. Alcoa S.S. Co., 234 F. 2d 249 21

Page

International Longshoremen's and Warehousemen's Union v. Kuntz, 334 F. 2d 165 8

Kane v. Union of Soviet Socialist Republics, 189 F. 2d 303 21

Kenney v. Trinidad Corporation, 349 F. 2d 823 27

Kermit, The, 76 F. 2d 363 6

Kossick v. United Fruit Co., 365 U.S. 731, 1961 A.M.C. 833 25

Los Angeles Shipbuilding & Dry Dock Corporation v. United States, 289 F. 2d 222 5

Mantin v. Broadcast Music, Inc., 248 F. 2d 530 8

McAllister v. Magnolia Petroleum Co., 357 U.S. 221 27

McChristian v. Lykes Bros. S.S. Co., 94 Fed. Supp. 149 12

Morales v. Moore-McCormick Lines, 208 F. 2d 218 .... 6, 12, 26

Oroz v. American President Lines, 259 F. 2d 636 .... 6, 12, 21

Phillips v. Hellenic, 179 Fed. Supp. 5 16

Pope & Talbot, Inc. v. Hawn, 346 U.S. 496 23

Pursche v. Atlas Scraper & Engineering Co., 300 F. 2d 467 6

Redman v. United States, 176 F. 2d 713 .... 10, 12, 13

Schwartz v. Eitel, 132 F. 2d 760 5

Seas Shipping Co. v. Sieracki, 328 U.S. 85 22

Smigiel v. Compagnie de Transports Oceaniques, 185 Fed. Supp. 328 .... 11, 12, 18

Tungus, The, 358 U.S. 588 27

Page

Vacci v. Swedish American Lines, 200 Fed. Supp. 207 8

Weigel v. The Belgrano, 299 F. 2d 897 26

Westfal Larsen v. Allman-Hubble Tugboat Co., 73 F. 2d 200 .... 8, 10

Wilson v. Iron Works, 212 F. 2d 510 10

Yerostathis v. A. Luisi, Ltd., No. 65-244-PH (S.D. Cal. 1966) 8, 9

Statutes

United States Code, Title 33, Sec. 913(a) 25

United States Code, Title 46, Sec. 18 23

United States Code, Title 46, Sec. 183(b) 25, 26

United States Code Annotated, Title 28, Sec. 1291 .. 1

United States Code Annotated, Title 28, Sec. 1333-(1) 1

Textbooks

Restatement of the Law of Agency, Sec. 268(a) .. 19

Restatement of the Law of Agency, Sec. 269 19

No. 20818

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

REGINO MARTIN ESPINO,

Appellant,

vs.

OCEAN CARGO LINE, LTD., etc., *et al.,*

Appellees.

Appeal From the United States District Court for the Southern District of California, Central Division.

APPELLEE'S BRIEF.

Jurisdictional Statement.

The admiralty and maritime jurisdiction of the district court in this cause is conferred by 28 U.S.C.A. §1333(1) and jurisdiction to review the district court's judgment is based upon 28 U.S.C.A. §1291.

Statement of the Case.

This litigation arises out of injuries allegedly sustained by appellant on February 29, 1964, while working in the hold of the S/S ATLANTIC GLADIATOR, a vessel then owned by appellee (hereinafter referred to as "respondent"), Ocean Cargo Lines, Ltd. The Libel alleges that appellant was, at the time of his injury, employed by the California Ship Service Com-

pany, a corporation, in the capacity of ship scaler, and was aboard the S/S ATLANTIC GLADIATOR in the course and scope of such employment.

The action in the district court was commenced by the filing of a libel *in personam* in admiralty on June 3, 1965, on a cause of action for negligence and unseaworthiness. [R. 28.] Paragraph XII thereof alleged as follows:

> "Libelant's suit is not barred by laches in that libelant was born in Cuba and cannot speak, read or write the English language, is uneducated and understood that his rights were limited to payments under Longshoremen's and Harbor Workers Act. At no time was he told by his employer or the Deputy Commissioner of Labor that he had any rights against the ship owner herein. Members of the crew of the vessel were present at the scene of the accident and were aware of it, and were in fact operating and controlling the winch and boom involved in the accident as above set forth, thus giving the officers and members of the crew of the vessel immediate knowledge that a serious injury to a worker had occurred. Respondents, and each of them, were thus put on notice of the accident and have not been prejudiced by any delay in the filing of this action by the libelant."

On August 13, 1965, appellant filed an amended libel, paragraph XII of which was in all respects identical to that of the initial libel. [R. 8-15.]

On August 26, 1965, respondent filed exceptions to the libel on the ground that appellant's claim was barred by laches [R. 16-17] and an affidavit by respondent's

counsel in support thereof. [R. 18-27.] Said affidavit averred in part as follows:

> "The S/S ATLANTIC GLADIATOR is a vessel which was owned by Ocean Cargo Line, Ltd., a member of the West of England Steam Ship Owners Protection & Indemnity Association. On July 19, 1965, I wrote to the West of England Association with a copy to Ocean Cargo Line (S. Livanos-Hellas, S.A., Piraeus, Greece) requesting information regarding the casualty, including information with respect to the availability of witnesses from among the ship's crew; the vessel's present whereabouts and current schedule; etc. On August 3, 1965, owners replied that they were unable to supply this information 'in view of the fact that this vessel is no longer owned by Ocean Cargo Line, Ltd., and the crew have long since scattered to various countries.' "

Appellant filed a memorandum of points and authorities in opposition to the exceptions on or about September 3, 1965. [R. Supp.] The matter was argued and submitted on September 7. On September 13 the district court's order sustaining the exceptions was entered. [R. Supp.]

The relevant portion of the order stated:

> "AND IT NOW APPEARING to the court that libelant's claim is barred by laches [Brown vs. Kayler, 273 F.2d 588 (9th Cir. 1959)]:
>
> "IT IS NOW, THEREFORE, ORDERED that said respondent's exceptions to the libel be and the same are sustained."

On September 23, 1965, appellant filed motion for leave to file second amended libel; memorandum of points and authorities in support thereof and proposed second amended libel. [R. 29-41.] The proposed second amended libel was identical to the predecessor except that it contained further allegations that:

> "As a direct result of libelant's inability to speak, read or write the English language, his lack of education and his misunderstanding of his rights, as aforesaid, libelant did not consult an attorney until May 13, 1965, fourteen and one half months after the date of the accident herein."

Respondent filed a motion to dismiss the proposed second amended libel, together with a memorandum of supporting points and authorities on September 29. [R. 41-43.] The matter was heard and submitted for decision on October 4. On October 6 the district court entered the following order:

> "AND IT NOW APPEARING to the court that the proposed second amended libel does not state a claim upon which relief could be granted:
>
> "IT IS NOW, THEREFORE, ORDERED that libelant's motion is denied."

On January 5, 1966, the district court ordered that judgment be entered against appellant in the following terms:

> "Libelant, Regino Martin Espino, having heretofore moved for leave to file a second amended libel in this matter, and said motion having been denied on the 6th day of October, 1965, and libelant, Regino Martin Espino, having elected to stand on such second amended libel without further motion to amend.

"The aforesaid libel of Regino Martin Espino is hereby dismissed and judgment of dismissal of said libel is ordered entered on the grounds that libel is barred by laches." [R. 48-50.]

Appellant's notice of appeal was filed the followed on January 14, 1966. [R. 50-51.]

Question Presented.

The question presented is whether the trial court abused its discretion in dismissing on grounds of laches appellants libel filed slightly more than 15 months after the alleged accident.

Prefatory Statement.

Appellant's opening brief makes two general assertions:

(1) That the trial court was confined to facts well pleaded in the libel, and erred in considering respondent's affidavit;

(2) That, on the merits, the trial court abused its discretion in dismissing for laches.

Before turning to a discussion of these two points it is appropriate to consider briefly the legal principles applicable to their review on appeal.

It is well established that trial court error will not be presumed on appeal.

Los Angeles Shipbuilding & Dry Dock Corporation v. United States, 289 F. 2d 222, 225 (9th Cir. 1961);

Schwartz v. Eitel, 132 F. 2d 760 (7th Cir. 1943).

Moreover, if error exists, it must be shown to have been prejudicial; if there be independent grounds to support the judgment, it judgment should be affirmed.

> *American Universal Insurance Co. v. Dykhouse,* 326 F. 2d 694 (8th Cir. 1964);
>
> *Pursche v. Atlas Scraper & Engineering Co.,* 300 F. 2d 467, 487-489 (9th Cir. 1962).

The case at bar is one involving dismissal on the ground of laches. The question of laches is addressed to the sound discretion of the trial court.

> *Gardner v. Panama R. Co.,* 342 U.S. 29 (1951);
>
> *Morales v. Moore-McCormick Lines,* 208 F. 2d 218 (5th Cir. 1953).

Accordingly, the trial court's judgment should not be disturbed on appeal unless it is so clearly wrong as to amount to an abuse of discretion, *e.g.,*

> *Goodwyn v. Dredge Ginger Ann,* 342 F. 2d 197 (5th Cir. 1965);
>
> *Oroz v. American President Lines,* 259 F. 2d 636 (2d Cir. 1958);
>
> *The KERMIT,* 76 F. 2d 363 (9th Cir. 1935).

SUMMARY OF ARGUMENT.

I.

THE TRIAL COURT WAS PRIVILEGED TO CONSIDER RESPONDENT'S AFFIDAVIT.

A. Exceptions To Libel Addressed To The Question Of Laches May Be Supported By Affidavits Or Exceptive Allegations.

B. The Trial Court Was Entitled To Regard Respondent's Motion As A Motion For Summary Judgment And To Consider Respondent's Affidavit In Connection Therewith.

II.

APPELLANT FAILED TO ALLEGE FACTS EXCUSING DELAYED INSTITUTION OF THE SUIT.

A. Appellant's Alleged Lack Of Education, Inability To Speak English, And Ingorance Of His Right To Sue Do Not Suffice To Excuse His Delay.

B. Appellant's Alleged Mistake Was One Of Law, Not Of Fact, and Resulted From His Failure To Make Such Inquiry As The Circumstances Required.

III.

APPELLANT FAILED TO ALLEGE FACTS NEGATIVING PREJUDICE TO RESPONDENT.

A. The Sale Of Respondent's Vessel Prior To Institution Of Suit Resulted In Prejudice To Respondent.

B. Appellant's Libel Fails To Allege Facts Rebutting The Presumption Of Prejudice To Respondent, And Was Properly Barred Without Reference To The Facts Set Forth In Respondent's Affidavit.

C. Mere Knowledge Of The Casualty By A Crew Member Does Not Amount To Notice Of Claim Served Upon A Vessel Owner Or His Authorized Agent.

IV.

THE CALIFORNIA STATUTE OF LIMITATIONS IS THE PROPER STANDARD OF GUIDANCE.

ARGUMENT.

I.

THE DISTRICT COURT WAS PRIVILEGED TO CONSIDER RESPONDENT'S AFFIDAVIT.

Exceptions to a libel addressed to the jurisdiction of the court or to the question of laches may be decided on the basis of affidavits or exceptive allegations calling the court's attention to relevant facts.

> *Westfal Larsen v. Allman-Hubble Tugboat Co.*, 73 F. 2d 200 (9th Cir. 1934).

It is clearly established that the court may consider motions to dismiss accompanied by affidavits as being in the nature of motions for summary judgment and enter judgment accordingly.

> *Vacci v. Swedish American Lines,* 200 Fed. Supp. 207 (E.D. Pa. 1961);
>
> *International Longshoremen's and Warehousemen's Union v. Kuntz,* 334 F. 2d 165 (9th Cir. 1964);
>
> *Mantin v. Broadcast Music, Inc.,* 248 F. 2d 530 (9th Cir. 1957).

Counsel for appellant in the case at bar well knew this to be the law, and were aware of appellant's right to file counter-affidavits, having raised, unsuccessfully, the same argument here relied upon in the case of *Yerostathis v. A. Luisi, Ltd.*, No. 65-244-PH (S.D. Cal. 1966). That case involved exceptions to a libel on *forum non conveniens* grounds. In sustaining the ex-

ceptions, Judge Pierson Hall answered counsel for appellant regarding the use of affidavits as follows:

> "The libelant asserts that affidavits may not properly be considered on exceptions to a libel in an admiralty proceeding, citing *Cleary Brothers, Inc. vs. Luria Steel and Trading Corp.* (D.C. N.Y. 1960), 198 F.Supp. 567. That case in turn depended for its authority on the *Sydfold* case (2d Cir. 1936), 86 F. 2d 611, where the court held that the question whether or not the statute of limitations had run could not be raised by affidavit. Since the decision of both of said cases, the Supreme Court has added Admirality Rule 58 for summary judgment, corresponding to Federal Rules of Civil Procedure Rule 56 which permits matters to be raised on motions for summary judgment by affidavits.
>
> "Where here the exceptions are not in the form of a motion for summary judgment, the net effect of what the respondents seek by their exceptions is a summary judgment that this Court exercise its discretion and decline jurisdiction. In such an instance it appears to me that the use of the affidavits to supply information necessary for a decision is proper."

[The full text of Judge Hall's opinion in the *Yerostathis* case is included herein as Appendix A.]

II.

THE TRIAL COURT DID NOT ABUSE ITS DISCRETION IN DISMISSING FOR LACHES.

A. Preliminary Statement.

It is settled law that suits brought under the general maritime law are not time barred by statutes of limitation, but may be barred by laches. Whether a claim is barred by laches depends upon whether there has been unreasonable delay in filing the suit and consequent prejudice to the party against whom it is brought. This question is addressed to the sound discretion of the trial court, and must be decided on the basis of all the facts and circumstances of each case. This, of course, does not mean that analogous state statutes of limitation are immaterial. The trial court may consider the analogous state limitation period as a standard for guidance. Although the statute should not be accorded conclusive effect, the courts commonly hold that after the comparable statutory period has run the libelant has the burden of establishing that the delay has not prejudiced the respondent, and that exceptional circumstances exist to excuse the delay.

Gardner v. Panama R. Co., 342 U.S. 29 (1951);

Czaplicki v. S.S. Hoegh Silvercloud, 351 U.S. 525 (1965);

Brown v. Kayler, 273 F. 2d 588 (9th Cir. 1959);

Wilson v. Iron Works, 212 F. 2d 510 (9th Cir. 1954);

Redman v. United States, 176 F. 2d 713 (2d Cir. 1949);

Westfal Larsen v. Allman-Hubble Tugboat Co., 73 F. 2d 200 (9th Cir. 1934).

B. Appellant Failed to Allege Facts Excusing the Delay.

Appellant's libel was filed more than fifteen months after the alleged injury, and more than three months after the time within which to file suit under the analogous California statute of limitations had expired. The only allegations in the libel or first amended libel to excuse this delay were, in substance, that libelant was born in Cuba and is unfamiliar with the English language; that he is uneducated; that he understood his rights were limited to those accorded under the Longshoremen's and Harbor Workers' Act; and finally, that at no time was he told by his employer or the Deputy Commissioner of Labor that he was entitled to sue the vessel owner.

To these allgations, appellant's second amended libel added only that appellant did not consult an attorney until fourteen and one half months after the alleged accident—in short, that the delay was not due to any inadvertence or omission by his attorneys, but was entirely his own fault.

These allegations bear a striking resemblence to those found in *Smigiel v. Compagnie de Transports Oceaniques*, 185 Fed. Supp. 328 (E.D. Pa. 1960). In that case, a longshoreman seeking recovery for personal injuries averred:

> "[H]e was born in Poland, had a limited comprehension of English, and a limited ability to speak English. He is uneducated. He was given to understand . . . that his rights were limited to the payments under the Longshoremen's and Harbor Workers' Act, 33 U.S.C.A. § 901, *et seq.* At

no time was he told by the Deputy Commissioner . . . he had any rights against the ship owner." 185 Fed. Supp. at 329.

The court concluded that these facts, even if proven, did not excuse the delay, saying:

> "While the oft-repeated rule 'ignorance of the law is no excuse' is not applicable in every case, we think it must be applied here. We think that giving special consideration to one man's rights over those of others because he is uneducated and has a limited comprehension of English would be unfairly preferring that man." *Id.*, at 329-330.

It has been repeatedly held that allegations of libelant's ignorance of the law, lack of education, and inability to speak English to not suffice to excuse undue delay in filing suit.

> *Redman v. United States*, 176 F. 2d 713 (2d Cir. 1949).
>
> *Brown v. Kayler*, 273 F. 2d 588 (9th Cir. 1959);
>
> *Oroz v. American President Lines*, 259 F. 2d 636 (2d Cir. 1958);
>
> *Morales v. Moore-McCormick Lines*, 208 F. 2d 218 (5th Cir. 1953);
>
> *Smigiel v. Compagnie de Transports Oceaniques*, 185 Fed. Supp. 328 (E.D. Pa. 1960);
>
> *McChristian v. Lykes Bros. S.S. Co.*, 94 Fed. Supp. 149 (S.D. Tex. 1950).

The case of *Morales v. Moore-McCormick Lines* is in all material respects on all fours with the instant case. The

Fifth Circuit Court of Appeals in upholding the trial court's judgment of dismissal, stated:

> "Here the appellants . . . claim special consideration on the ground that being ignorant and unlettered persons, a different standard should apply in their case. Their only excuse for delay in filing suit is that they did not appreciate the lingering effect of their illness and that they did not appreciate their legal right to bring a third party action for negligence. . . . As to their claim of ignorance of their legal right to sue a third party, the steamship lines which had contracted with their employer, *we know of no principle which enables persons to plead, not excusable ignorance of facts, but of the law which accorded them the right to sue.*" (Emphasis added.) 208 F. 2d at 221.

Similarly, in *Redman v. United States, supra,* the Second Circuit Court of Appeals made it clear that even if a libelant is ignorant of material *facts,* his ignorance must not be due to the failure to make reasonable inquiry. The libelants in that case argued that due to the nature of their injuries they were not fully aware of the fact that they had been injured for some time. In answer to this argument, the court held that:

> "Ignorance of facts material to a claim will not preclude the application of the doctrine of laches when ignorance is due to failure to make *such inquiry as the circumstances reasonably suggest.*" (Emphasis added.) 176 F. 2d at 715, 716.

In *Brown v. Kayler, supra*, the libelant filed suit in admiralty two months after the analogous state statute

of limitations had run. To overcome the *prima facie* prejudice resulting from this delay, libelant argued:

> "[L]ibelant is an Indian and unfamiliar with legal matters and had no knowledge of whether this was a trade name, a company, or a corporation, but believed and reported to his counsel that it was a corporation."

The District Court held that,

> "None of the excuses or reasons for delay are sufficient to overcome the presumption of prejudice to respondent. *None of these reasons present a condition which proper diligence could not have avoided.*" (Emphasis added.) 156 Fed. Supp. 11.

This court affirmed the judgment of dismissal on the grounds of laches.

> *Brown v. Kayler,* 273 F. 2d 588 (9th Cir. 1959).

For purposes of this appeal, respondent is compelled to accept appellant's averments that he was ignorant of his right to bring suit. However, this allegation by itself is not meaningful. Though given every opportunity, appellant failed to allege facts showing an exercise of proper diligence. It does not appear that he made inquiries of his employer, his union representative, the deputy commissioner of labor or anyone else concerning his right to sue. Since "it must be assumed" that his libel, as amended, "presented appellant's case in its most favorable light" (*Brown v. Kayler,* 273 F. 2d at 592), one can only conclude that no such inquiries were made. When one is injured by what he feels to be another's negligence, "proper diligence" would certainly seem to contemplate his deter-

mining whether he had a right to sue the allegedly negligent party. It would appear, therefore, that not only was appellant's alleged mistake one of law and not of fact, but it was necessarily grounded upon his "failure to make such inquiry as the circumstances reasonably [suggested]."

C. Appellant Failed to Allege Facts Negativing Prejudice to Respondent.

1. The Undisputed Facts Set Forth in the Affidavit Establish Clear Prejudice to Respondent.

The affidavit of respondent's counsel states that, though prompt steps were taken to develop information necessary to defend the suit, respondent was not able to supply this information because the vessel had been sold and its crew scattered to various countries. Although appellant had full opportunity to file counter-affidavits in an attempt to negative this clear showing of prejudice, he failed to do so. Appellant relied instead upon the argument that respondent's affidavit should simply be ignored because it failed to specify the date on which the vessel was sold—a curious approach from one upon whom the burden rests to establish that no prejudice resulted from his long delay. The gist of appellant's reasoning is that if it be *assumed* that the vessel was sold within a year following the accident, then respondent could not possibly be prejudiced since the libel, *had it been timely filed*, would not have been barred by laches. Clearly, this reasoning is fallacious. It confuses the fact of prejudice with an unrelated legal result. Had the libel been filed after the assumed date of sale, but within one year after the casualty, libelant could probably have avoided the defense

of laches on *grounds of excused delay*—notwithstanding prejudice to respondent. In this respect, the instant case falls squarely within the rationale of *Phillips v. Hellenic*, 179 Fed. Supp. 5 (S.D. N.Y. 1959):

> "[I]t is undisputed that the vessel upon which the alleged injury was sustained was sold by respondent, Compania Internationale de Pores Lta. approximately seven months after the accident and, since the first time it can be charged with knowledge of libelant's claim was March 1957 [subsequent to sale], prejudice seems too patent to be seriously denied." 179 F. Supp. at 8.

2. The Presumption of Prejudice Whice Results From Untimely Filing Is Alone Sufficient to Bar Appellant's Action.

Quite apart from the averments of respondent's affidavit, it is clear that appellant has failed to rebut the presumption of prejudice that flows from delayed filing. In an effort to satisfy this burden, appellant alleged, in essence, that members of the ship's crew had knowledge of the accident. The trial court, in the exercise of its discretion, found that these allegations were not sufficient.

Under certain circumstances, libelant's timely notice of claim may enable a vessel owner to fairly investigate and prepare to defend an anticipated lawsuit, notwithstanding the fact that the libel is not promptly filed. This is not aways the case, however, and it is clear that notice alone will not *ipso facto* rebut the presumption of prejudice. As the court stated in *Cleary*

Brothers, Inc. v. Luria Steel and Trading Corp., 198 Fed. Supp. 567 (S.D. N.Y. 1960):

> "Libelant's allegations do not aver sufficient facts to prove the absence of laches. The general allegations that there were numerous settlement discussions would not excuse the delay, and the fact that respondent had timely notice of the claim would not itself rebut laches. Timely notice would enable respondent to prepare its defense but nothing will take the place of prompt institution of suit and the resulting avoidance of prejudice arising from death or forgetfulness of witnesses." 198 Fed. Supp. at 570.

Clearly, the question of prejudice remains the touchstone. It is imperative that notice, if given, must be of such character as to fairly apprise the vessel owner of libelant's intention to hold him liable for his injuries so that the latter can investigate and prepare its defense. Each of the cases relied on by appellant stand for this proposition alone. Each involves a fact situation in which the vessel owner either was notified of libelant's claim or actually investigated the circumstances of the accident soon after its occurrence. Thus, in *Cities Service Oil Co. v. Puerto Rico Lighterage Company*, 305 F. 2d 170 (1st Cir. 1962), a collision action cited in appellant's brief (p. 6), the court gounded its decision vacating the trial court's dismissal upon the fact that:

> "The respondent was notified of the alleged collision and of libelant's claim for damages by cable . . . more than nine months before the analogous

> statute of limitations had run. . . . Respondent was made fully aware of the nature of the claim and was afforded adequate opportunity to investigate it." *Id.* at 171, 172.

The court added that the witnesses aboard were still in respondent's employ and that the chief officer, called by respondent as a witness, had a distinct recollection of the relevant facts.

In *Fidelity Casualty Company of New York v. C/B Mr. Kim,* 345 F. 2d 45 (5th Cir. 1965), which is also relied upon by appellant (App. Br. p. 6) a formal letter demand was sent to respondent four months after the accident. The respondent's attorney requested and received medical reports and engaged in settlement negotiations with libelant thereafter.

Likewise, in *Smigiel v. Compagnie, supra,* the court, after noting that ". . . in fact, the libel avers that respondent *did* make such an investigation" at the time of the accident, dismissed the exceptions on condition that the trial judge was convinced by libelant's evidence that respondent, "through its authorized agents, had knowledge of the accident at or about the time of its occurrence."

In *Claussen v. Mene Grande Oil Co.,* 275 F. 2d 108 (3d Cir. 1960), the court found that:

> "[I]t is clear that respondent knew of the injury and of appellant's claim very soon after the event. This is demonstrated by the fact that on December 1, 1947, less than three months after the accident [respondent], instructed Gulf to compensate appellant during its disability, and that such payments were actually made for several months at

> [respondent's] expense . . . It seems a fair inference that [respondent] made whatever investigation of the accident it considered appropriate during this period immediately after the accident." *Id.*, at 113.

The *Claussen* court went on to note that libelant had filed timely suit against a related corporation, Gulf Corporation, and that:

> "It appears that counsel who represented Gulf in the trial of this suit in the Western District of Pennsylvania is also representing [respondent] now. Gulf defended the Pennsylvania suit fully on the merits, although decision turned upon nonownership of the vessel." *Ibid.*

The *Gardner v. Panama Railroad Co.* case (App. Br. pp. 14-15) involved a passenger injured aboard respondent's vessel who put respondent on notice of her claim by twice filing actions against respondent within the year following her accident, each of which was dismissed for reasons unconnected with the merits of her claim.

The conclusion which flows from these cases is that the courts are concerned ultimately with the opportunity afforded the vessel owner to adequately prepare and defend against a claim of liability. Knowledge of the accident by a member of the ship's crew, a source ill-calculated to call the matter to owner's attention, was not a determinative factor in any of them. The distinction between mere knowledge of a servant and formal notice of claim directed to a vessel owner or its authorized agent is clear and well-recognized

Restatement, Agency, §§ 268(a), 269;

Addison v. Huron Stevedoring Corp., 96 Fed. Supp. 142 (S.D.N.Y.) at 158-159;

Foorman v. Myers, 1 Cal. App. 2d 719 (1934) at 722.

In each of the cases discussed heretofore, proper notice was afforded. In the case at bar appellant was granted a reasonable opportunity to plead such notice or other facts rebutting the presumption of prejudice in its various libels, or by way of affidavit had it chosen to do so. Appellant could not and did not do so. On these facts the trial court can hardly be said to have acted arbitrarily in finding against appellant on the question of laches.

III.

THE CALIFORNIA STATUTE OF LIMITATIONS IS THE PROPER STANDARD OF GUIDANCE.

The case at bar presents but one issue on appeal; whether the trial court abused its discretion in dismissing the libel and entering judgment for respondent. That issue is dispositive. From the record, and for the reasons heretofore stated, it is clear that the district court's judgment was well within the bounds of its discretionary power, and in accordance with the clear mandate expressed by this court in *Brown v. Kayler*, and the long line of cases which it followed. Appellant's brief pays little heed to this central issue, but relies, to a large extent, upon the assertion that the court below committed legal error in following *Brown v. Kayler*, and using as the preceptive standard the California one year statute of limitations instead of the three year period afforded by the Jones Act. The question of which statute

was the appropriate standard of guidance was neither briefed nor argued below. Moreover, the record contains not the slightest indication that the trial court accorded determinative significance to either statutory period. It reflects only the court's considered judgment that appellant's inexcusable delay prejudiced respondent, and facts more than adequate to support that judgment. Accordingly, this case is not one which compels a decision as to which statute of limitations should be applied as the standard of guidance. Nevertheless, in view of the weight appellant appears to attach to the contention that the Jones Act limitation period applies, we deem it necessary to respond.

Appellant requests this court to overturn the long line of cases culminating in *Brown v. Kayler.* The request is made on the basis of the decision in *Flowers v. Savannah Machine & Foundry Co.,* 310 F. 2d 135 (5th Cir. 1962),* which concededly is at variance with the cases not only in this circuit, but in other circuits as well. *E.g.,*

Czaplicki v. S.S. Hoegh Silvercloud, 351 U.S. 525, 76 S. Ct. 946 (1956);

Oroz v. American President Lines, 259 F. 2d 636 (2d Cir. 1958);

Guerrido v .Alcoa S.S. Co., 234 F. 2d 249 (1st Cir. 1956);

Kane v. Union of Soviet Socialist Republics, 189 F. 2d 303 (3d Cir. 1951).

*The only other authority cited by appellant is the opinion in *Glidden vs. Isbrandtsen Co.*, 355 F. 2d 125 (4th Cir. 1966). While containing dictum recognizing the propriety of reference to the Jones Act as a guide, this case states only that the analogous state statute of limitations may be considered, and, in the last analysis, stands only for the proposition that neither prescriptive period should have a decisive influence.

The *Flowers* case involved a personal injury action in admiralty against a vessel owner by a shore based worker. The libel was filed subsequent to the running of the analogous state statute of limitations. By exceptions respondents urged that the libel was barred by laches. Libelant contended that the Jones Act limitation period rather than the state statutory period should be applied by analogy and that, if so applied, laches was not a bar. The district court rejected libelant's contention and, holding that libelant had failed to rebut the presumption of laches, dismissed the libel. On appeal, the circuit court, after noting that respondent's supporting affidavits cast considerable doubt on the intrinsic merit of its claim, went on to hold that the trial court had erred in selecting the state rather than the Jones Act standard. It specifically disclaimed any intention of passing on the merits of the laches question and remanded the case for "further and consistent" proceedings in the trial court.

The reasoning of the *Flowers* decision appears to be that:

(1) A shore based worker who by the authority of *Seas Shipping Co. v. Sieracki,* 328 U.S. 85 (1946), is considered to be a "vicarious seaman" for purposes of the seaworthiness doctrine should, by reason of that fact, be entitled to draw by analogy upon the three years statute of limitations of the Jones Act; in short, that the policies which support the three year limitation afforded to Jones Act seamen apply equally to longshoremen and other "vicarious seamen";

(2) The use of the Jones Act statute of limitations as the analogous limitation period would have the advantage of promoting national uniformity of decision in the maritime field.

We will address ourselves to each of these points in turn.

Initially, it should be stated that the fact that the *Sieracki* court equated, longshoremen with seamen in order that they might have a cause of action for unseaworthiness does not mean that they should be, or are, treated as seamen for other purposes. Thus, a seaman is entitled to maintenance and cure. A longshoreman is not. [*Dryden v. Ocean Accident & Guarantee Corp. Ltd.*, 138 F. 2d 291 at 293 (7th Cir. 1943)]. A seaman may prosecute his suit without prepayment of costs. A longshoreman may not. [*Borselli v. United States,* 74 Fed. Supp. 822 (1947)]. In a variety of other areas Congress has sharply differentiated between the rights of seamen as contrasted to harbour workers. [*Pope & Talbot, Inc. v. Hawn,* 346 U.S. 406 at 424-426; 46 U.S.C. §§ 18 *et seq.*] Clearly, there is no logic in assuming that a longshoreman, having been classified as a seaman for the limited purpose of the unseaworthiness doctrine, is also to be treated as a seaman for other and unrelated purposes.

Moreover, as the court in *Dawson v. Fernley & Eger,* 196 Fed. Supp. 816 (1961) stated to treat a longshoreman as a seaman for purposes of the Jones Act limitation period would:

> ". . . substantially nullify the Congressional action of 1927 when the legislative branch of our government saw fit to withdraw the longshoremen from the benefits of the Jones Act. There is no more

reason to hold that a longshoreman's period of limitation is governed by the Jones Act than there is to conclude that a longshoreman may maintain an action under the Jones Act, which admittedly he cannot do since Congress acted to overturn *International Stevedoring Co. v. Haverty*." *Id.*, at 821.

In deciding whether the court should apply by analogy the Jones Act limitation period in longshoremen cases, the policies upon which the Jones Act period rests should be examined. In enacting the Jones Act, Congress could have adopted any of the shorter state limitation periods, or it could have provided for application of the doctrine of laches which looks to state law as a guide. It chose neither course, but elected, rather, to accord the Jones Act seaman a *longer, fixed* period within which to bring suit. Clearly, the unique circumstances affecting the seaman's calling merit this result. A Jones Act seaman is a transient who is bound by ship's articles and the necessities of his profession to spend extended periods at sea far from the continental limits of the United States. When his ship touches port, it is generally for a brief period during which it bunkers and takes on cargo for another port in another state or country. Clearly, the seaman is faced with unique difficulties in bringing suit which justify a long limitation period of uniform applicability. The protracted periods at sea during which he has no access to legal counsel or the courts obviously bespeaks the need for a long statute of limitations. Since the seaman can hardly be expected to know the different limitation periods which obtain in the various states his ship may call on, and in which he may be obliged to bring suit, it is important that his right to sue be governed by a single fixed limitation period.

The Jones Act seaman is commonly not a resident of the state in which he brings suit. Accordingly, the state's legitimate interest in matters affecting its own residents is generally not a factor. As the Supreme Court in *Kossick v. United Fruit Co.,* 365 U.S. 731, 1961 A.M.C. 833, noted:

> "[I]t blinks at reality to assert that because a longshoreman, living ashore and employed ashore by shoreside employers, performs seaman's work, the state with these contracts must lose all concern for the longshoreman's status and well-being." *Id.,* at 739.

None of these incidents of the seaman's trade, which go to make up the policy foundation for the Jones Act limitation period, apply with respect to longshoremen.

In enacting the Longshoreman's and Harbor Workers' Act, Congress provided that longshoremen claims must be filed within one year after injury. [33 U.S.C. §913(a).] Similarly, Congress has recognized the application of a one year limitation period with respect to passenger claims. [46 U.S.C., §183(b).] Clearly, longshoremen, passengers, and other land-based individuals stand on an entirely different footing from the seagoing worker insofar as their ability to bring prompt suit is concerned. The variant circumstances of the Jones Act seaman and the longshoreman or other "vicarious" seaman, therefore, compels the conclusion that there is no logic in favoring the latter with a more extended period than that enjoyed by their fellow land-based neighbors.

The second and closely related basis advanced by the *Flowers* court in support of its decision is the policy

favoring national uniformity in the maritime field. The opinion, unfortunately, covers this point in conclusionary terms, and does not discuss the reasons why this policy requires adoption of the Jones Act period as the preceptive standard in longshoremen cases. It goes without saying that there are many areas in which the need for national uniformity is of compelling significance. As we have heretofore noted, the prosecution of seamen's claims falls into this category. The unique nature of the seaman's trade and the interstate and international character of ocean commerce necessitate uniform laws which individual states cannot provide. These factors are not present where we are concerned with the claims of nontransitory, non-seamen, shipboard workers. This is an area in which the state's interest is of predominant significance and in which the need for national uniformity is not apparent.

Beyond this, it is axiomatic that disuniformity is an inherent feature of the federal system; national uniformity cannot be achieved except at the cost of local uniformity.

> *Morales v. Moore-McCormick Lines, supra*, at 220;
>
> *Cleary Brothers, Inc. v. Luria Steel and Trading Corp., supra,* at 569.

To adopt the reasoning of the *Flowers* court would result in a host of anomalies. It would mean that the longshoreman injured aboard ship would stand in a different position from a fellow longshoreman injured ashore [*Weigel v. The Belgrano*, 299 F. 2d 897 (9th Cir. 1962)]; or the passenger or casual visitor injured aboard ship [46 U.S.C. §183(b)]; or his own family if

he were killed aboard ship. [*The Tungus,* 358 U.S. 588 (1959).] If the injured longshoreman were to prosecute his claim in a state court, he might well be bound by the state statute of limitations.

See

> *McAllister v. Magnolia Petroleum Co.,* 357 U.S. 221, 224, n. 5.

Yet, if he chose to proceed in admiralty, under the *Flowers* decision, he could look forward to the much longer Jones Act period being adopted by analogy. Clearly, this result encourages forum shopping, and would run directly *contra* to the clearly expressed policy in favor of local uniformity articulated by the Supreme Court in *Erie R.R. v. Tompkins,* 304 U.S. 64 (1938), and *Guaranty Trust Company v. York,* 326 U.S. 99 (1945).

It is interesting to note that several years after the *Flowers* decision the Fifth Circuit Court of Appeals again had occasion to consider the appropriate balance which should be affected between the need for national uniformity in the maritime field and the scope of state competence. This case, *Kenney v. Trinidad Corporation,* 349 F. 2d 823 (5th Cir. 1965), involved an action for the alleged wrongful death of a seaman. Libelant asserted that laches rather than the state one year statute of limitations should be applied. On appeal, the circuit court affirmed the trial court's decision rejecting this contention and applying the state statute of limitations as a bar. In so doing, the Fifth Circuit indicated that there was *no* strong policy favoring the federal concept to the exclusion of the state statute.

> "[T]here is no strong policy of the forum requiring application of the doctrine of excusable laches to state wrongful death actions . . . [I]n applying

> the doctrine of laches, federal courts are usually guided by the period of the analogous state statute of limitations. After the statutory period has run, the libelant has the burden of proving that the delay has not prejudiced the respondent and that there is a good excuse to justify his invocation of the doctrine." *Id.*, at 839.

By its attempt to achieve national uniformity in an area where there exists no strong policy favoring national uniformity, and in which complete national uniformity is not possible, the *Flowers* decision has intruded upon an area of state competence, and has ignored policies favoring local uniformity of a much more compelling nature. In this it has not and should not be followed.

Conclusion.

Although appellant was accorded ample opportunity to allege facts excusing his failure to file suit promptly, he failed to do so. The trial court properly held that appellants libel was barred by laches. The judgment should be affirmed.

Respectfully submitted,

McCutchen, Black, Verleger & Shea,
Howard J. Privett,
Winchester Cooley III,
Attorneys for Appellee.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

WINCHESTER COOLEY

APPENDIX.

Order Declining Jurisdiction.

United States District Court, Southern District of California, Central Division.

Nestor Yerostathis, also known as Nestor Gerostathis, Libelant vs. A. Luisi, Ltd. and Shipping Developments Corp., Respondents. In Admiralty. No. 65-244-PH.

The Complaint is in two counts, one, under the Jones Act for negligence, and the other, unseaworthiness. Libelant asks general and special damages for the loss of four fingers and seeks to proceed under the provisions of Title 28, U.S.C. § 1916, without prepayment of fees or costs or security therefor.

The respondents have filed exceptions to the libel and supported the exceptions with affidavits concerning many material things about which the Company is silent.

The libelant asserts that affidavits may not properly be considered on exceptions to a libel in an admiralty proceeding, citing *Cleary Brothers, Inc. v. Luria Steel and Trading Corp.* (D.C. N.Y. 1960), 198 F. Supp. 567.[1] The case in turn depended for its authority on the *Sydfold* case (2 Cir. 1936), 86 F. 2d 611, where the court held that the question whether or not the statute of limitations had run could not be raised by affidavit. Since the decision of both of said cases, the Supreme Court has added Admiralty Rule 58 for summary judgment, corresponding to Federal Rules of Civil Procedure Rule 56 which permits matters to be raised on motions for summary judgment by affidavit.

---

[1]Cf. *Fleet Corp. v. Rosenberg Bros.* (1928), 276 U.S. 202, 214.

While here the exceptions are not in the form of a motion for summary judgment, the net effect of what the respondents seek by their exceptions is a summary judgment that this Court exercise its discretion and decline jurisdiction. In such an instance it appears to me that the use of the affidavits to supply information necessary for a decision is proper.

From these affidavits we learn (1) that the vessel is registered under the Greek flag and manned by Greek subjects; (2) that respondent Shipping Developments Corp. is the owner and is incorporated and registered in Panama; and has its principal office in Piraeus, Greece; (3) that respondent A. Luisi, Ltd., is a British corporation whose stockholders are British citizens, and it acts as general agents of the owners; (4) that the libelant is a Greek citizen; (5) that he signed on at Belgium; (6) the ship's articles and his contract of employment are in the Greek language; (7) that by terms of the articles and contract any "claims due to illness or accident, the law courts of Athens will be solely competent"; (8) that the libelant was second engineer on said vessel (and the Court takes judicial notice that that position is one of considerable responsibility, whether the libelant was literate or illiterate); (9) that the injury occurred on October 8, 1963; (10) that on the 10th of October, 1963, the respondents repatriated the libelant to Greece by air from Chittagong, Pakistan, at the respondents' expense; (11) that on his arrival at Greece he was immediately met by a Greek doctor where he underwent an operation; and (12) that all

maintenance and expenses thereof were paid by the respondents. The libelant filed no affidavits, and its libel [verified by counsel on information and belief] is not contrary to any of the foregoing, except it alleges Luisi owned the ship. It is immaterial for the purpose of this motion as to whether Shipping Developments Corporation or Luisi was the owner.

The courts have discretion in declining to take jurisdiction in admiralty suits between foreign nationals. *Canada Malting Co. v. Peterson Steamships, Ltd.*, 285 U.S. 413; *Koziol v. The Fyglia* (2 Cir. 1956), 230 F.2d 651, cert. den. 352 U.S. 827.

The exceptions of the respondents to the libel are sustained, and the Court declines to accept or take jurisdiction for the reason that the libelant is a Greek; the contract by which he signed on was in Greek; he was returned to Greece by respondents after the accident and thus had access to the law courts of Athens which he agreed would be "solely competent" to determine any disputes concerning injury. It would be a grave abuse of discretion to do otherwise. See *Lauritzen v. Larsen* (1953), 345 U.S. 571.

In a case somewhat comparable to the instant case, *Hatzoglou v. Asturias Shipping Company, S.A.* (S.D. N.Y. 1961), 193 F. Supp. 195, the court declined jurisdiction conditioned upon the respondent's agreeing to submit itself to jurisdiction in Greece. Inasmuch as the libelant in this case made no effort whatsoever to disclose to the court what the Greek law is or why the

libelant, when he was in Greece, did not take advantage of his contract to recover under Greek law, after being flown there at the expense of respondents, I see no reason why such a burdensome condition should be imposed upon the respondents in this case.

It Is Hereby Ordered that the exceptions to the libel are sustained, and the case is dismissed, for the reason that the Court declines to take jurisdiction.

Dated: Los Angeles, California, February 23, 1966.

PEIRSON M. HALL
United States District Judge

(Seal)

NO. 20818

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

REGINO MARTIN ESPINO,

Appellant,

vs.

OCEAN CARGO LINE, LTD.,
etc., et al.,

Appellees.

APPELLANT'S REPLY BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

MARGOLIS and McTERNAN

3175 West Sixth Street
Los Angeles, California 90005

Attorneys for Appellant

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MARGOLIS and McTERNAN

3175 West Sixth Street
Los Angeles, California 90005

Attorneys for Appellant

TOPICAL INDEX

	Page
RESPONDENT'S EXCEPTION COULD NOT BE TREATED AS A MOTION FOR SUMMARY JUDGMENT UNDER ADMIRALTY RULES.	1
CONCLUSION	3
CERTIFICATE	4

TABLE OF AUTHORITIES

Cases

Mantin v. Broadcast Music, Inc., 248 F. 2d 530 (9th Cir. 1957)	2
Westful Larsen v. Allman Hubble Tugboat Co., 73 F. 2d 200 (9th Cir. 1934)	2

Rules

Admiralty Rules:	
Rule 58	1, 2, 3
Federal Rules of Civil Procedure:	
Rule 56	2

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RESPONDENT'S EXCEPTION COULD NOT BE TREATED AS A MOTION FOR SUMMARY JUDGMENT UNDER ADMIRALTY RULES

Respondent urges in its brief that an exception to a libel, accompanied by affidavits, may be considered as a motion for summary judgment under Admiralty Rule 58. In setting forth this argument, respondent conveniently ignores the requirements of Rule 58, to wit:

"Rule 58. Summary Judgment . . .

"(e) Form of affidavits - Further testimony -

Supporting and opposing affidavits shall be made on

personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. . . ."

The affidavit filed by respondent herein was not made on personal knowledge and did not show affirmatively that the affiant was competent to testify to the matters stated therein. Furthermore, all of the material contained in the affidavit relative to prejudice was hearsay and would have been inadmissible in evidence (C. 18-25). The cases cited by respondent in support of the proposition that a Court may consider a motion to dismiss accompanied by affidavits as being in the nature of a motion for summary judgment make it abundantly clear that the requirements of Admiralty Rule 58 and Civil Rule 56 must be strictly followed as a prerequisite to entry of judgment. (See, for example, Mantin v. Broadcast Music, Inc., 248 F. 2d 530, 532 (9th Cir. 1957).)

Without the benefit of Rule 58, the use of an affidavit by respondent was clearly unauthorized. In Westful Larsen v. Allman Hubble Tugboat Co., 73 F. 2d 200 (9th Cir. 1934), cited by respondent as authority for the proposition that exceptions addressed to the question of laches may be decided on the basis of affidavits or exceptive allegations, no affidavits were involved. Rather, appellee in the Westful case had submitted "exceptive allegations" in response to a libel in which appellant had given no reason for a delay and facts showing laches appeared on the face of the appellant's

pleadings. No additional facts were alleged in the exceptive allegations relative to laches. By way of contrast, respondent herein has attempted to meet appellant's assertion of lack of prejudice by way of an affidavit containing information not disclosed on the face of the libel and not within the personal knowledge of the affiant. Thus, respondent's exception fails if treated as analogous to a demurrer because it requires the Court to look outside the pleadings for information to sustain the exception and it fails if treated as analogous to a motion for summary judgment because the affidavit does not conform to the requirements of Admiralty Rule 58.

Disregarding the affidavits filed by respondent, the exception should not have been sustained. Appellant's libel contained allegations asserting excusable delay and lack of prejudice to respondent - nothing further was required to overcome an exception based on laches.

CONCLUSION

WHEREFORE, for all of the reasons and considerations above stated and those expressed in Appellant's Opening Brief, it is respectfully submitted the judgment below should be reversed and the cause reinstated for trial.

Respectfully submitted,

MARGOLIS and McTERNAN

By: WILLIAM G. SMITH

Attorneys for Appellant

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ William G. Smith
WILLIAM G. SMITH

No. 20822

In the

United States Court of Appeals
For the Ninth Circuit

INSURANCE COMPANY OF NORTH AMERICA
a corporation

Appellant,

vs.

THOMAS J. THOMPSON,

Appellee.

BRIEF OF APPELLANT

Appeal from the United States District Court
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Southern Division

RICHARDS, HAGA & EBERLE
711½ Bannock St.
Boise, Idaho
Attorney for Appellant

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RICHARDS, HAGA & EBERLE
711½ Bannock St.
Boise, Idaho
Attorney for Appellant

SUBJECT INDEX

PAGE

TABLE OF CASES ..... ii, iii, iv

TABLE OF STATUTES v

TEXTS CITED v

JURISDICTION 1

STATEMENT OF FACT 2

A. PRIOR DISABILITIES FROM INJURIES 4

B. THE INCIDENT AND DISABILITIES FROM THE ACCIDENT OF SEPTEMBER, 1963 10

C. ADDITIONAL ACCIDENT AND DISABILITY OF FEBRUARY, 1964 20

D. WHETHER APPELLEE IS TOTALLY DISABLED 29

E. OTHER FACTUAL POINTS 32

QUESTIONS PRESENTED 32

SPECIFICATION OF ERRORS 33

ARGUMENT 52

SUMMARY OF ARGUMENT 52

A. THE POLICY OF ACCIDENT INSURANCE 52

B. BURDEN OF PROOF UNDER POLICY 61

C. IS APPELLEE'S CLAIM WITHIN THE POLICY 64

1. *Second Accident Caused Lower Extremity Pain* 68

2. *The Event of February 21, 1964, Was Caused By Pre-existing Bodily Infirmities* 73

3. *Disability Not Due To Medical Treatment Within Accident Policy* 74

D. APPELLEE HAS NOT SHOWN TOTAL DISABILITY OR PROPER PROOF OF LOSS 77

E. THE COURT BELOW COMMITTED SUBSTANTIAL, PREJUDICIAL ERRORS AT TRIAL 82

1. Admission and Rejection Of Evidence 83

2. Errors In Instructions To The Jury 90
3. Prejudicial Remarks Of The Court 93
APPENDIX A-1
TABLE OF EXHIBITS A-1
CERTIFICATION A-3

TABLE OF CASES

Aetna Life Insurance Co. v. Brand, 265 Fed. 6, 13 A.L.R. 657, cert. den. 40 S.Ct. 587, 253 U.S. 496, 64 L.Ed. 1031 69
Armstrong v. Bergeron, 104 N.H. 85, 178 A.2d 293 72
Beams v. John Hancock Mutual Life Insurance Co. (Sixth Circuit), 325 F.2d 887 58
Bennett v. New York Life Insurance Co., 63 Idaho 427, 121 P.2d 551 80
Columbian National Life Insurance Co. v. Buntin, 43 Ga. App. 698, 159 S.E. 891 82
Conlon v. Northern Life Insurance Co., 108 Mont. 473, 92 P.2d 284 80
Corbett v. Clarke, 187 Va. 222, 46 S.E.2d 327 72
Corbett v. Phoenix Mutual Life Insurance Co., 259 N.Y.S. 221, 144 Misc. 872 82
Coulson v. Wenzel Hotels, Inc. (First Dist. App. Ct.), 248 Ill. App. 540 97
Crowe v. Equitable Life Assurance Society of the United States, 179 La. 444, 154 So. 52 82
Davis v. Jefferson Standard Life Insurance Co. (C.C.A. 5th, Ga.), 73 F.2d 330, cert. den. 294 U.S. 706, 79 L.Ed. 1241 . . . . 53, 59, 60
Davis v. North American Accident Insurance Co. 42 Wash. 2d 291, 254 P.2d 722. 76
De Legrand v. United States (Dist. Ct., Puerto Rico), 182 F. Supp. 184 88
Evans v. Continental Life and Accident Co., 88 Idaho 254, 398 P.2d 646 61
Federal Life Insurance Co. v. Raley, 130 Tex. 408, 109 S.W.2d 972 71
First National Bank v. Equitable Life Assurance

Society of United States, 225 Ala. 586, 114 So. 451 . . . 56
Forte v. Schiebe, 145 Cal. App.2d 296, 302 P.2d 336 . . . 95
Goldstone v. Rustemeyer, 21 Idaho 703, 123 Pac. 635 . . . 95, 96
Hartzog v. United States (Fourth Circuit), 217 F.2d 706 . . . 84
Hays v. Viscome, 122 Cal. App.2d 135, 264 P.2d 173 . . . 98
Herthel v. Time Insurance Co., 221 Wis. 208, 265 N.W. 575 . . . 56
Hork v. Minneapolis Street Railway Co., 193 Minn. 366, 258 N.W. 576 . . . 87
Hovhanesian v. New York Life Insurance Co., 310 Mass. 626, 39 N.E. 2d 423 . . . 82
Kane v. Order of United Commercial Travelers of America, 3 Wash.2d 355, 100 P.2d 1036 . . . 77
Kennedy v. Underwriters at Lloyd's, London, 32 Cal. Rptr. 685, 219 Cal. App.2d 11 . . . 79
Kiger v. The Idaho Corporation, 85 Idaho 424, 380 P.2d 208 . . . 70
La Chase v. Sanders, 142 Conn. 122, 111 A.2d 690 . . . 95, 96
Lado v. First National Life Insurance Co., 182 La. 726, 162 So. 579 . . . 60
Liberty National Life Insurance Co. v. Bailey, 34 Ala. App. 199, 38 S.2d 295 . . . 55, 60
Linder v. City of Payette, 64 Idaho 656, 135 P.2d 440 . . . 70
Long v. Equitable Life Assurance Society of the United States, 70 Ohio App. 277, 60 N.E.2d 805 . . . 79
Lucas v. Metropolitan Life Insurance Co., 339 Pa. 277, 14 A.2d 85 . . . 63
Maryland Casualty Co. v. Morrow (C.C.A. Third), 213 Fed. 599, 52 L.R.A. (N.S.) 1213 . . . 56, 77
Mason v. United States (C.C.A. Vt.), 63 F.2d 791 . . . 94
Metropolitan Life Insurance Co. v. Rosier, 189 Okl. 448, 117 P.2d 793 . . . 63
Moore v. Southern Life & Health Co. (La. Ct. of

App.), 195 So. 857 60
Mutual Life Insurance Co. v. Dodge (C.C.A. 4th), 11 F.2d 486, cert. den. 271 U.S. 677, 70 L.Ed. 1147 70
New York Life Insurance Co. v. Bruner, 129 Ind. App. 271, 153 N.E.2d 616 59
New York Life Insurance Co. v. McNeely, 52 Ariz. 181, 79 P.2d 948 ....61, 62
O'Neil v. New York Life Insurance Co., 65 Idaho 722, 152 P.2d 707 ....38, 54
Purchase v. Seelye, 231 Mass. 434, 121 N.E. 413 .. 72
Rauert v. Loyal Protective Insurance Co., 61 Idaho 677, 106 P.2d 1015 58
Regenvetter v. Ball, 131 Wash. 155, 229 Pac. 321 89
Reserve Life Insurance Co. v. Luedke, 132 Ind. App. 476, 177 N.E.2d 482 79
Rhoda v. Metropolitan Life Insurance Co., 354 Pa. 313, 47 A.2d 152 60
Romanoff v. Commercial T. M. Accident Association, 243 App. Div. 725, 277 N.Y.S. 291 76
Russell v. Glens Falls Indemnity Co., 134 Neb. 631, 279 N.W. 287 57
Silverstein v. Metropolitan Life Insurance Co., 254 N.Y. 81, 171 N.E. 914 59
Washington National Insurance Co. v. Chavez (Tex. Civ. App.), 106 S.W.2d 751 63
Welte v. Metropolitan Life Insurance Co., 305 Ill. App. 120, 27 N.E.2d 63 58
Westmoreland v. Preferred Accident Insurance Co. (Cir. Ct., N.D. of Ga.), 75 Fed. 244 74
Wilson v. New York Life Insurance Co. (Dist. Ct., Idaho), 82 F. Supp. 292, aff'd 178 F.2d 534 (Ninth Circuit 1949) 54, 69, 75

TABLE OF STATUTES

Sec. 9-413 to 9-416, Idaho Code 83
28 USC, Sec. 1291 2
28 USC, Sec. 1332 1
28 USC, Sec. 1732 83

TEXTS CITED

5 Am. Jur. 2d, Appeal and Error, Sec. 789, p. 230 (1962) 99
1A Appleman, *Insurance Law and Practice*, p. 529 (1965) 82
32 Corpus Juris Secundum, Evidence Sec. 633b, p. 804 (1964) 89
32 Corpus Juris Secundum, Evidence Sec. 730(2), pp. 1053, 1054 (1964) 84
10 *Couch On Insurance 2d*, Sec. 41:7, pp. 29-30 (1962) 55
10 *Couch On Insurance 2d*, Sec. 41:114, p. 145 (1962) 71
10 *Couch On Insurance 2d*, Sec. 41:384, p. 351 (1962) 60
Prosser on Torts, Sec. 49, pp. 272-273 (2d ed., 1955) 71
2 Restatement of Torts 2d, Sec. 457, comment d, p. 498 (1965) 71

No. 20822

In the

United States Court of Appeals For the Ninth Circuit

INSURANCE COMPANY OF NORTH AMERICA
a corporation

Appellant,

vs.

THOMAS J. THOMPSON,

Appellee.

Appeal from the United States District Court
for the District of Idaho
Southern Division

BRIEF OF APPELLANT

I. JURISDICTION

Jurisdiction is conferred by 28 USCA Section 1332. The Complaint was filed in the District Court of the Third Judicial District of the State of Idaho, in and for the County of Ada, on January 7, 1965. (R. 10-12). Appellant filed its Petition for Removal of said cause to the United States District Court for the Southern Division of Idaho on January 27, 1965 (R. 6-8), The District Court found jurisdiction in its pretrial conference order (R. 47).

Jurisdiction of the Circuit Court of Appeal is based on the fact that Appellant filed its Notice of Appeal herein on December 10, 1965 (R.220) appealing from the Final Judgment entered in the action on the 24th day of November, 1965 (R.182) based upon the verdict of the jury finding for the Plaintiff dated November 18, 1965 (R.179) and the Decision of the court fixing attorneys fees in favor of the Plaintiff, and further appealing from the Order of the court (R. 218) denying Appellant's motions of December 2, for Judgment notwithstanding the verdict (R. 187-192) and alternative motion of appellant for new trial (R.194-196).

Jurisdiction of this Court in this Appeal is confirmed by 28 USCA Section 1291 based upon said Notice of Appeal and the undertaking on Appeal properly filed herein (R. 222-223).

II STATEMENT OF FACT

This is an action by the Appellee to recover the total and permanent disability benefits allegedly due to him under an optional accident and disability insurance policy issued by Appellant. Appellant's policy OKU 6303 was issued to Morrison-Knudsen, Inc., and affiliated companies covering a period of July 1, 1963, through July 1, 1964, whereby Appellant agreed to insure such eligible persons who elected to become insured under the policy by meeting its conditions and paying the premium (See policy, R. 37-45, Exhibit 4). Appellee was an employee of Constructora Emkay, S.A., a Nevada corporation, subsidiary of Morrison-Knudsen, Inc., and applied for coverage under said insurance policy on a standard application form (R.48,

Exhibit 5). No medical examination was required, the effective date of the policy was September 1, 1963, and there was deducted from the pay of said Appellee for the months of September and October a monthly amount of $6.25. (T.R. 40). The insurance was effective through October 31, 1963. (T.R. 240). Only salaried employees of said companies after 90 days of employment were qualified to obtain the policy. (TR 242-243)

Appellee, at his last birthday on January 21, 1963, was 56 years old (R. 52, TR 11). Prior to the accident on September 9, 1963, appellee had been involved in a number of industrial accidents. Following the alleged accident on September 9, 1963, Appellant received a letter about the injury on or about August 19, 1964, and on or about September 9, 1964, received the completed standard Proof of Loss and physician's statement signed by Appellee and Appellee's doctor, Dr. Jerome E. Burton, both dated September 8, 1964. (R. 52, TR 3-4).

The appellant's policy of insurance protects

> ". . . against specified loss described in Part 1—Description of Coverage resulting directly and independently of all other causes from bodily injuries caused by accident while this policy is in force . . ."
>
> "This policy does not cover loss caused by or resulting from any one or more of the following:
>
> A. . . .
>
> B. . . .
>
> C. . . .
>
> D. Illness, disease, pregnancy, childbirth, miscarriage, bodily infirmity or any bacterial infection

other than bacterial infection occurring in consequence of an accidental cut or wound,

E. . . ." (R37, 39, Ex. 4)

A. PRIOR DISABILITIES FROM INJURIES.

Prior to the alleged accident of September 9, 1963, Appellee had suffered numerous disabling injuries. Proceeding backward in time, on May 24, 1963, Appellee was involved in an explosion and tunnel fire on the same job near Bogota, Columbia, resulting in material burns to his hands, face and lungs, together with other minor injuries. Appellee's witness, Dr. Franklin David, had examined Appellee on December 31, 1963, for evaluation of the disability from such burns and had found that he had a partial bronchial obstruction, he had poor aeration of the lungs on deep breathing, and ". . . with very minimal exercise, he was very short of breath." (TR. 213) He evaluated the pulmonary disability as to a percentage of disability of the whole body as 40% of the total. (TR 220) The history Mr. Thompson gave Dr. David was that afer the tunnel fire, ". . . he noticed shortness of breath, less physical endurance, cannot walk in hills like before without stopping and resting, and chronic cough." (TR 217). The fact, unrelated to the September 9, 1963, accident was also testified to by Mr. Thompson, who stated that he was in the hospital 24 days after the fire (TR 246), was off the job from May 24, to July 10, 1963 (TR 47), and he would notice his shortness of breath after walking a couple of blocks (TR 50). Dr. David also noted calcified nodules in both lung fields as evidence of early pulmonary fibrosis (TR 218), chronic bronchitis, emphysema and wheezing indicating asthma (TR 219). Dr. David further stated as to the relation of the May 24th tunnel fire

and the disability existing at the time of the trial that

> "Well, the relationship would be that certainly some of it (disability) still exists and any further impairment imposed upon his previous impairment would perhaps more significantly disable him now." (Tr 21)

When given a hypothetical question listing all of the previous events of injury to Appellee, the doctor stated that while you could not total these to reach a total pre-existing disability,

> "Q. But they would add an accumulation of disability, would they not in some extent?
>
> "A. Yes, I think they would increase his pre-existing disability to that of his September 9, if that is what you mean." (TR 223)

The degree of disability is shown by the fact that Appellee after he returned to work could not return to his normal job until sometime in August (TR 51), thus being in some condition of recovery from the May 24 event for at least 2½ months. It is interesting to note that the application for the insurance here involved was made August 23, 1963.

The next accident prior to the fire of May 24, 1963, was an injury of April 19, 1963. Working on the same job in Columbia, Appellee strained his right side and groin while lifting a steel support, developing a hernia that is still painful (TR. 107), and losing maybe two days' work. (TR 61-62)

Prior to this injury, Appellee suffered an injury on June 26, 1962, while mining for the Eby Construction

Company on construction of Titan missile silos. Appellee slipped on some grease and oil while going over some equipment and ". . . went down through these machines and I hit my back on one of the machines when I went down through them." (TR-62) He was off work for approximately two months, taking pain pills for two to two and one-half months, for injury to the back around the belt line. (TR-62). The industrial accident rating was ten per cent of the loss of the leg at the hip. (TR-82).

The next injury suffered by Appellee was October 24, 1961, at Hardin, Montana. He was bent over putting some steel behind a rock drilling machine when the machine toppled over on top of him, striking him in the neck and back. (TR-63).

Prior to this, the Appellee suffered an injury on August 20, 1960, while working for the Gilmore and Skoubye Steel Construction Company. In working around steel reinforcing, he raised up, striking his head against abar which had been placed above Appellee's position and welded in place without his noticing it, creating a complaint of headaches and aching in his neck. (TR-64). He was off work approximately two and one-half months. (TR-65). The industrial disability rating on this injury was ten per cent of the loss of the arm at the shoulder.

Prior to this, the Appellee suffered a major injury on August 24, 1953, while he was timbering a drift in a mining job for the Cordero Mining Company in Nevada. A slab of rock fell on his head and he suffered pain in his head, neck and some pain in his right arm and right shoulder. He spent a considerable time in re-

habilitation, including physical therapy and wearing a neck brace for approximately three to four months. He was off the job approximately eight months. (TR 55, 56) As a result of this injury, he received industrial accident rating of a disability equal to twenty-five per cent of the total body. (TR-82). Dr. Mack of Reno, Nevada, who treated him in part for this injury stated that despite such treatment he had almost constant headaches, episodes of neck pain, weakness in the right hand and arm and occasional episodes of numbness in the forearm with considerable stiff neck. (TR-323) Examination by Dr. Mack revealed that despite the statements of pain, the examination did not reveal any reflex changes nor did x-rays reveal any gross defect. The diagnosis by Dr. Mack at that time was:

> "This man appears to have a root compression syndrome. On physical examination it is difficult to make out which root is involved. I think it possibly is C-7 on the right . . . at that point it was my impression that it might be necessary to undertake a root decompression . . ." (TR-325)

Dr. Mack followed the patient as a neurological specialist from October until the end of April, 1954. As late as March 1954, Dr. Mack still stated that Appellee complained of severe headaches and inter-scapular pain with pain between the shoulder blades. (TR-328) Questioned concerning the findings of Dr. Kiefer on the operation of the cervical spine in February of 1964 and the fact that Dr. Kiefer found anterior to the nerve root at the C-7 level a hard protrusion accompanied by osteophyte (a small bony outgrowth) formation, Dr. Mack stated as to this possibly relating back to the 1953 instance that:

> "Yes, that is possible, that is a chronic condition which has to have existed for some years. While one cannot be dogmatic about the number of years, it is very possible that this relates to the extent of ten years previously." (TR-334)

The severity of the 1953 injury to the neck in the same area as the 1964 injury is indicated by the fact that Dr. Mack found in the earlier examinations of the Appellee that he had limited motion of his neck in all directions, and that considerable pain continued through the period of more than eight months after the accident, which inclined the doctor to recommend surgery, which Appellee refused (TR-329).

Another injury about this same time was an instance on November 10, 1955, where the Appellee was working at Cobalt, Idaho, and strained his back lifting a timber. He was off work approximately five days at that time. (TR-66). Also on October 31, 1952, he picked up a machine, stumbled and wrenched his back. He was off work approximately one week. (TR-67).

Prior to this a major accident occurred to the Appellee on November 11, 1947, while working for the Cordero Mining Company in Nevada. At that time he was running a drilling machine, the steel broke and the machine tipped over backwards at which time Appellee sought to grab the machine and fell off the platform, falling about six feet and landing on his back across a stack of timbers. He was off work a little over a year following that accident and had a fusion operation with bone grafts from his legs. (TR-65-66) This resulted in a solid surgically fused lumbrosacral joint (TR-179) with a disability rating by the Industrial Ac-

cident Commission of Nevada of twenty-five per cent of the whole body. (TR-66) Since the 1947 accident Appellee's ability to bend forward and back has been extremely limited including his inability to tie his shoes. (TR-265, 359)

Appellee has worked up to positions of responsibility in supervising large groups of construction workers and miners. (TR-11-13) Some time in 1959 he went to Iran for Morrison-Knudsen Company, where he was assistant superintendent (TR-15), with 60 to 70 men under him most of the time and toward the end of the job as many as 150. (TR-75) Prior to going to Iran he worked on the Brownlee Dam Project in Hell's Canyon on the Snake River from 1955 to 1958, where he supervised approximately 35 men. (TR-77) He went to El Colegio in South America in September, 1962, as foreman or walking boss (TR-18) and supervised some 35-40 men. (TR-77) His responsibilities, particularly in Iran, included teaching the men how to run the machines and use powder (TR-15), making a daily log of what was done with drilling reports and powder reports, approving the daily work list of men, writing accident reports and break-down reports (TR- 392) and dealing with the government officials of Iran. (TR-393)

As to the condition of Appellee prior to the September, 1963, incident, even Appellee admitted he had some preexisting disabilities:

> "Q. As I understand your counsel, he asked you if by May, before the tunnel fire you had any disabilities?
>
> "A. Had any disabilities?

> "Yes, that is possible, that is a chronic condition which has to have existed for some years. While one cannot be dogmatic about the number of years, it is very possible that this relates to the extent of ten years previously." (TR-334)

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As to the condition of Appellee prior to the September, 1963, incident, even Appellee admitted he had some preexisting disabilities:

> "Q. As I understand your counsel, he asked you if by May, before the tunnel fire you had any disabilities?
>
> "A. Had any disabilities?

"Q. Yes, and you said no, none that prevented you from doing your work; is that correct?

"A. If he was referring back to the accidents I had had before, I had some disability ratings on those?

"Q. That is what I wanted to clarify.

"A. No, I didn't.

"Q. You didn't mean you haven't had these disabilities?

"A. No, I didn't mean to say I hadn't been hurt before and had some disabilities." (TR-97)

Following the above testimony, Appellee stated after the fusion operation in 1948 he couldn't bend over too far and could "touch his knees pretty good." (TR-98)

B. THE INCIDENT AND DISABILITIES FROM THE ACCIDENT OF SEPTEMBER, 1963.

There is no dispute as to the fact that while the accident and disability policy was in effect Appellee suffered an accident on September 9, 1963, on the El Colegio Tunnel job near Bogota, Colombia. As set forth in Appellee's own words at TR-22-24, Appellee had taken the shift for one of his co-shift bosses who had to be gone, and was on the ground going around to the other side of the jumbo to check on drilling where about fifty gallons of hydrocloric oil had been spilled from a loose hose. He stepped in this oil and

"My feet flew out from under me and I fell backwards and hit my neck on a piece of steel that we call a collar brace . . ." (TR-23).

He ended up in a semi-reclining position and did not in-

jure his arms or legs. (TR-52) He was not unconscious, but did notice pain in the back of his head and his neck and shoulders. He sat on some timber in the tunnel until lunch time when he caught a motor and rode outside, went to the first aid building and then to his quarters. The next morning he went to Bogota to see a doctor. He was placed in the hospital for some two weeks where he received pain medicine and physical therapy. He stayed in his quarters at the job thereafter visiting the doctor in Bogota about once a week, and returned to the United States about October 23, 1963. (TR-25, 28).

In the various histories that Mr. Thompson gave the number of doctors that diagnosed him, it appears that his only complaint from the September 9, 1963, accident was of headaches, neckaches and associated shoulder pains. He did not give a history of any other complaints to Dr. Burton. (TR-106) Likewise, after two examinations by Dr. Manley Shaw, an orthopedic surgeon, it is specifically stated that he did not have any complaints in his lower extremities until after February of 1964. (TR-194) Likewise, Dr. Edward Kiefer, a neurosurgeon of Boise, Idaho, and the surgeon that did the cervical laminectomy on February 28, 1964, states the history given him by the Appellee prior to the February myelogram and operation were complaints of limited motion and pain in the cervical spine, diminished sensation of the index and fourth finger of the left hand and pain in the head, neck, shoulder and left arm. (TR-290-291) He did not complain of any pain in the low back or legs, other than telling Dr. Kiefer about the 1948 lumbar disc operation. (TR-308)

By the verified complaint, Appellee alleges the Sep-

tember 9, 1963, accidental injury to his spine caused "immediate, total disability." (R-11). Likewise, the proof of loss form, TR-85, Exhibit 3, states the date of the accident for which disability is claimed is shown as September 9, 1963. The attending physician's statement attached to the proof of loss in the same exhibit states the injury was:

> "Fractured C-7 Spinus process; ruptured cervical disc."

Again the date of the accident for which the claim is made is September 9, 1963.

The result of the accident of September 9, 1963, is quite certain despite considerable confusion caused by Appellee's primary witness, Dr. Jerome K. Burton. Both in the statement of physician with the proof of loss, dated September 8, 1964, and Dr. Burton's letter of September 9, 1964, (Exhibit 19, R-78), the inability of Appellee to return to work is based upon ". . . the ruptured cervical disc." Thus six months after the operation performed by Dr. Kiefer and after at least eight visits to Dr. Burton by Appellee, his diagnosis is based upon a fracture of the spinus process of the C-7th, a ruptured cervical disc, and the fact that Dr. Kiefer had removed such cervical disc at the C-7th level. Dr. Burton admitted that if there had been a ruptured disc the disability of the Appellee would have been much more severe, (TR-413) and admitted that he did not know even a year after the injury that in fact it wasn't a ruptured cervical disc (TR-414 L13). This was despite the fact that there are ample records in the hospital of notes of the operation as well as other examinations by Dr. Shaw on July 21, 1964, who through use of the x-rays and myelograms pre-

viously taken correctly diagnosed the injury. (TR-177, 179). Another physician of the Appellee's, Dr. Franklin David, who examined him in January, 1965, easily determined that the Appellee had had a laminectomy, an operation removing a portion of the posterior arch of the vertebrae, not the disc. (TR 210) Yet, when Dr. Burton was asked if the fact there was no ruptured cervical disc involved made any difference in the amount of the disability, all he would give was a wisecrack. (TR-414, L19)

The actual facts of the injuries suffered were brought out by Dr. Edward Kiefer, who treated Appellee at the request of Appellee's counsel (TR 291). He examined the Appellee on February 20, 1964, and promptly sent him to the hospital for a myelogram study, which was performed the next day. This was after Dr. Burton had seen the Appellee numerous times. (Exhibit 3) Dr. Kiefer, after medical school and training at the Mayo Clinic, has a degree of Master of Surgery in neurological surgery from the University of Minnesota, being a member of the American Medical Association, the Harvey Cushing Society, and the Board of Neurological Surgery (TR-102, 289-90). Summarizing Dr. Kiefer's findings, he determined that prior to surgery there was localized tenderness in the C-6th level, Appellee was uncomfortable in flexion of the cervical spine and very uncomfortable on extension and lateral rotation to the left of the cervical spine. He found no other deviations from normal in the neurological examination except definitely diminished sensation of the index, middle and fourth finger of the left hand. (TR 291-292) The myelogram was performed at his request and interpreted by the radiologist with findings consistent with the small disc

protrusion from the left at the C-7th level and possibly one level higher on the right side. The radiologist did not find any fracture of the spinus process of the C-7th or other cervical vertebraes, nor did Dr. Kiefer in the operation find any fracture. (TR 293-4) Likewise, Dr. Manley Shaw, a member of the American College of Surgeons and a diplomat of the American Board of Orthopedic Surgeons (TR 176), from x-rays and the record of the previous examination did not find any evidence of fracture (TR 177, 179). Dr. Kiefer made a complete neurological examination and only on the biceps reflex (concerning the nerve root emerging between the 5th and 6th cervical vertebrae) did he find the left side a little less than the right side. (TR 192)

Because of the diagnosis of possible disc protrusion, surgery was performed on February 28, 1964, by the removal of sufficient lamina tissue to create a "window," and the lamina of C-7 and the inferior portion of the lamina of C-6 were removed, carried out far laterally to decompress the nerve root at the foramem. At the time of the operation, Dr. Kiefer found:

> "Anterior to the nerve root . . . this is in front of the nerve root . . . at this level (C-7th) there was a hard disc protrusion— and I should have put this in quotation marks—actually it was accompanied with osteophyte formation in the area. In order to have removed this disc adequately, it was felt there was too much traction would have to be exerted against the nerve root or against the spinal cord. It was therefore felt that a decompression was the treatment of choice. In other words, what we did was to take one jaw of the vice away from the nerve root." (TR-297).

"Q. Now, Mr. Thompson spoke in relation to the osteophyte on the nerve pressure.

"A. It is very definite that he did have an osteophyte at the C-6-7 level.

"Q. This would create more or less pressure on the nerve?

"A. More.

"Q. Would it be in association with the lamina pressure or in addition to it?

"A. Actually it would have no relationship to the lamina . . ." (TR-300)

"Q. Now in Mr. Thompson's case Dr. Kiefer, when you went in and operated you found this osteophyte—what I am trying to get at is what is the relationship of the symptoms of the pain that Mr. Thompson felt and the, first, disc portrusion and, secondly, the existence of the osteophyte?

"A. Well, it must be assumed that the osteophyte was a preexisting condition." (TR-300)

It will be noted that the doctor did not find a fresh disc protrusion, but a "hard disc protrusion," as well as the osteophyte formation in the cervical spine. The evidence is uncontradicted that an osteophyte takes a number of years to be formed and could not be the result of the accident of September 9, 1963. It is a part of the wear and tear form of arthritis. (TR 299) The preexistence of the osteophyte condition leads to the question of the preexistence of the "hard" protrusion of the disc. Dr. Manley Shaw as Appellee's witness stated on this matter:

"He had had, of course, I think two other previous

> neck injuries. The disc as it was found in the operation was not a fresh, acutely herniated degenerated disc, but more or less a boney fibrous ridge that indicates this probably accumulated over a fair period of time." (TR 203)

This was likewise confirmed by Dr. Ernest Wood Mack of Reno, Nevada, who stated that as to the osteophyte formation found by Dr. Kiefer in 1964 relating back to the 1953 accident:

> "Yes, that is possible, that is a chronic condition which has to have existed for some years. While one cannot be dogmatic about the number of years, it is very possible that this relates to the extent of ten years previously." (TR 334)

Likewise, Dr. John Raaf, commenting with reference to the opinion of Dr. Mack that in 1953 there appeared to be a nerve root compression syndrome at the C-7th level and as to the findings of Dr. Kiefer in 1964 of the disc protrusion on the left side between C-6 and 7 and on the right side between C-5 and 6, that:

> "I would think that the prior injury would have some effect on his symptoms for which he was operated upon in Boise." (TR 366)

Further, Dr. Raaf testified that:

> "It is difficult to deny that the trauma or the injury to his neck which he sustained on September 9, 1963, didn't aggravate the osteoarthritis. To answer your question more specifically, I think the osteoarthritis is almost totally responsible for his neck symptoms. Had he not had the arthritis I think his neck symptoms would have quickly subsided.

"Q. And would it be your opinion or would it not, Dr. Raaf that the previous injury in 1963, even though it was to the left side, and the injuries in 1960 and September of 1963 to the left (right) side, would have increased the amount of arthritis, the earlier ones, or had any affect on it?

"A. It could have increased, and it probably did increase the arthritis." (TR 373)

The evidence was uncontradicted as to the existence before September 1963 of both the hard protruding disc and the osteophyte growth at the C-6 and 7th levels. Between the accident and the cervical laminectomy operation, there had been some progression of the symptoms in the left arm and fingers, and the operation relieved both the headaches, diminished the pain in the neck, and reduced any numbness in the left arm and fingers. Thus Appellee's witness, Dr. Shaw, stated:

"Well, prior to the surgery, he was apparently having progressive neurological problems and persistent severe pain. His persistent severe pain in the cervical area and the apparent progress of the neurological changes in his hand were stopped, although he still has persistent numbness in the fingers and pain in the neck and shoulder area but of a much less degree." (TR 204)

"I found no evidence of sensory loss, no evidence of atrophy, no evidence of circulatory disturbance." (TR 177)

"Q. Now with reference to any numbness he has in his left arm, did you find any significant numbness on his last examination?

"A. He seems to have less ability to perceive pain-

ful sensation of pinprick or pin scratch over the area of the thumb and index finger.

"Q. Would this or would it not affect his use of his muscles except for the separate set of nerves as I understand it?

"A. Well, they are the same nerves, but there seems to be no motor impairment, that is, there is no atrophy of the small muscles of the hand and he had no apparent difficulty in rapid motion. This might impair finer functions of the fingers, such as picking up very small objects like a pin or tying his shoe laces and that sort of thing.

"Q. With his left hand?

"A. Yes.

"Q. Do you find any such limitation in his right hand?

"A. No sir.

"Q. He would be able to do the finer things with his right hand?

"A. Yes." (TR 191)

Dr. Kiefer's last examination of the Appellee showed the only residual from the cervical spine matter, as far as objective symptoms, was some hypothesia in the left hand fingers (TR 305), and that his cervical spine injury did not disable the Appellee from his employment. (TR 307). Appellee's witness, Dr. Shaw concluded to the same end in stating that:

"Q. If Mr. Thompson on September 9, 1963, Dr. Shaw, had been as normal as anybody that age is, let's say, would this fall and the injury to his cervical

spine cause total disability from what you have seen from him?

"A. Yes, I think so, considering the other problem that he had.

"Q. I am trying to eliminate the other problems and ask you separate from this.

"A. Yes, I think he would have been totally disabled, I mean had he not had surgery afterwards. I think he got considerable relief from the surgery." (TR 203-204)

"A. In other words, you are asking me if the injury of September 9 alone would have prevented him from returning to his previous occupation after surgery?

"Q. After surgery, yes.

"A. Well, there again this is difficult to answer because one of the primary things, I think, is the amount of pain and the individual's tolerance to pain with it. The physical examination and the x-ray evidence is not sufficient as far as limited motion and neurologic deficit is concerned to completely disable him. The only residual injury which he had or the only injury that he did have apparently is herniation or fibrosis of the disc which we assume is a result of the injury because his pain started then. Limited motion in the neck and residual discomfort in the neck, I think, are compatible with some heavy labor. This would depend to a certain extent on just what type of heavy labor he had to do. I would think any type of labor that involved turning his neck a lot and looking up overhead and lifting at the same time

would be particularly troublesome and might be disabling.

"Q. But it wouldn't in itself prevent him from returing to work if the other factors had not existed?

"A. I don't believe so, no." (TR 205)

C. ADDITIONAL ACCIDENT AND DISABILITY OF FEBRUARY, 1964.

Prior to the cervical operation, as noted above, a diagnostic myelogram was performed. Exhibit 6, the St. Alphonsus Hospital records commencing February 20, 1964, show that prior to going for a myelogram Appellee had had some empirin compound No. 3 and went up for his myelogram at 8:40 on February 21. He was there perhaps 45 minutes and was returned to his room before noon. (TR 55) After he had returned to his room and had been lying flat two hours or so Appellee contends he got out of bed to go to the bathroom and was immediately struck by pain from his hips down to his ankles, to the extent that at first he thought he was paralyzed. He had to hold onto the bed and reach over and get the bathroom door and hang on to things in the bathroom coming and going. (TR 32). He claims to have had the same pain continually since that time. Appellee stated:

"It was when I first got out of bed and stepped to my feet down on the floor and stood up is when the pain hit me." (TR 56)

"Q. In other words, you didn't feel this pain while you were lying there in bed?

"A. No, I didn't feel the pain until I got up and stood up.

"Q. Did the pain when you stood up at that time affect your neck?

"A. Affect my neck?

"Q. Yes.

"A. No. sir, I don't think so.

"Q. Now, after you got back in bed, did you have occasion to call a nurse or call a doctor?

"A. Yes.

"Q. How soon?

"A. I called nurse and talked to her and asked her what would cause that pain like that and she said she didn't know.

"Q. Did you call your doctor?

"A. No, I didn't call the doctor. They told me that the doctor would be in to see me later." (TR 57, 58)

"Now, Mr. Thompson, between the date of the myelogram on the 21st of February and when you had your operation on the cervical spine on the 28th, which was hurting worse, your legs or your neck or shoulders?

"A. Well, I believe my legs hurt the worst because I did take the pain medicine for the pain in my neck and shoulders.

"Q. It would relieve that pain but not your legs?

"A. It was strong enough to relieve it yes.'" (TR 59)

Exhibit 6, the hospital records, contradict appellee's statements. Dr. Burton was asked to review the record

for the 20th, 21st and 22nd, in relation to the alleged onset of the leg pains. He could find nothing but a headache noted, admitted that after a myleogram a headache and perhaps a backache around the point of injection was normal, and admitted that it was certainly usual that if the Apellee had a sudden onset of pain, called the nurse and told her about, that the same would be entered on the record. (TR. 156-158) Dr. Kiefer was asked to examine the same exhibit for the period after the myelogram as to whether there was anything abnormal which would indicate a recation to the myleogram. He stated there was not, and that if the appellee had had a violent reaction to the myelogram, quite likely he would have had increased temperature of at least 100 degrees, from an inflammation reaction with a corresponding rise in his pulse. He further stated that any reaction to the myelogram should show up in the first 24 hours, or by 48 hours at most, none of which temperature, pulse or other record is shown on the hospital records. (TR 295-96.) Further, Dr. Kiefer, as the operating and attending physician following the myelogram stated he had no independent recollection of any severe pain reported to him by the appellee following the myelogram. (Tr. 310.)

Appellee's witness, Dr. Shaw, likewise reviewed the record of the hospital and to the question of whether the chart confirmed in any manner appellee's testimony as to extreme pain in his lower extremities after the myelogram, stated he did not find any indication of such in the way of pulse, temperature or remark of nurses that indicated this. (Tr. 187.) He specifically testified that if appellee had had such sudden and severe pain which he reported to the nurses, that it would be customary to have it written down on the

chart. (Tr. 188.) As to any entry concerning pain in the lower extremities, Dr. Shaw, as well as the other doctors, could only find an entry at 10:30 in the morning of February 25th, stating, "resting, states funny pain in left arm and leg, leg pain felt after myelogram is gradually diminishing." (Tr. 195, Exhibit 6.) Then the following day at 9:00 o'clock at night there is an entry that he complained of "aching pain in the left leg." Tr. 195.

Dr. Shaw further examined the record to determine whether there was any particular medication given which would indicate severe pain. His testimony at Tr. 196-7 shows the appellee complained of a headache after the myelogram, which is fairly common, and was given empirin compound No. 3 at 1:30 p.m. following the myelogram. He likewise received the same compound at 11:00 p.m. that night and at 2:00 a.m. on the 22nd. Further, at 3 a.m. on the 22nd, the date following the myelogram, he complained of severe headache and distension of abdomen and hiccups. He was given an enema. It was not until 2:45 on the following day, the 23rd, that he received the next pain medication and no pain medication was given on the 24th. On the 25th he received the same compound at 11:30 in the morning, and at 9:30 that night complained to the nurse of an aching pain in the leg above noted and was given the same compound. On the 26th he was given the same compound at 9 o'clock in the morning. That same night he received the compound at 10:00 o'clock and at 10 a.m. on the morning of the 27th received the same compound for constant dull ache in the neck. At the same time, of course, he complained of numbness in the middle three fingers. At 3:40 that afternoon he was given the same compound, which was

administered again at 9 p.m. that night and at 11:45 also. He went for surgery on the next day, the 28th.

Dr. Shaw, commenting on this record of medication, which he found apparently was empirin compound No. 3 all the way through, stated this was not a particularly strong pain killing medicine, but an effective one, and if the appellee had had severe pain, he probably would have had a hypo administered. (Tr. 200-201.) The doctor notes that the amount of pain compound given was more or less routine. Dr. Shaw finally states:

> "Q. In other words, would you say that from this intermittent medication there was any evidence of severe pain or moderate pain or lack of pain?
>
> "A. Well, this is difficult to evaluate from the chart actually, but this does not indicate he was having extreme pain." (Tr. 201.)

Appellee's testimony was that the disability of the lower extremities was created by the pain, as noted immediately following stepping out of bed after the myelogram and continued unabated down to the present time. (Tr. 57) After the cervical operation, the mild pain medicine would stop the ache that Mr. Thompson reported to continue in his neck and left shoulder, but did not relieve the pain in his legs. (Tr. 43, 59.) The nature of this disability in the legs was consistently reported to the various doctors as pain in the legs, cramping in the legs and being able to walk only about four blocks before having to sit down and rest (Kiefer, Tr. 303) (David, Tr. 210) (Raaf, Tr. 364). It is to be noted that there is some difference in the report of the doctors and that of Appellee in that the charley horse or cramping in the legs apparently

stopped after he stops walking and again develops only upon use of the legs. When testifying as to attempting to work in May of 1964, Appellee made it clear that the legs cramp and hurt much worse when he tries to use them, such as walking three blocks. (Tr. 37)

The nature of the disability of Appellee's lower extremities is uncertain. Appellee's main medical witness, Dr. Burton, examining him August 20, 1964, stated it to be "cramping and aching of muscles in his legs" (Tr. 110), and called it an adverse reaction to the dye used in the myelogram. Yet Dr. Burton admits it is impossible to know whether the Appellee has arachnoiditis without a biopsy of the tissue being done (Tr. 170), and admits there are insufficient symptoms at this time to be certain that it is arachnoiditis (Tr. 174).

Concerning the incident of February 21, 1964, none of the professional witnesses except Dr. Burton claimed its residual result was related to the cervical injury, and none believed that it was arachnoiditis, or was able to confirm the alleged pain and cramping by the existence of any objective symptoms. The onset of the leg disability was sudden and violent. Yet each doctor agrees that any reaction to the myelogram, which is due to irritation to the membranes of the spinal cord, to cause such sudden pain would have to have been associated with reportable marked increase in temperature and associated increased pulse rate, which, of course, did not exist. Dr. Raaf, who has actually published on the subject, (TR 381), testified specifically that at the greatest extreme, you would not expect any pain or discomfort in the lower extremities to last

more than a few weeks as the result of a myelogram (TR 362), that he doubts the myelogram could have triggered the present pain in the legs (TR 362), that any reaction from irritated membranes due to the myelogram is unusual if it does not go away within a few days to a few weeks (TR 377), and that since he had practiced as a neurosurgeon in Portland beginning in 1936 he had only observed one case that he could remember of irritation from myelogram in the legs (TR 371). Even so, he had never seen a case where the reaction to a myelogram came on with severe pain within a couple of hours, within the facts described by Mr. Thompson. (TR 377-78). Dr. Raaf very specifically concluded that Appellee's pain in the lower extremities could not be arachnoiditis from the myelogram and made a differential diagnosis that to the extent of cramping or 'charley horses' from walking, the pain might clearly be indicated to be due from intermittent claudication (TR 363-4). He thought it likely, except for temporary aggravation from the myelograms, to be due to preexisting conditions, particularly in the lower spine from the previous fusion operation. (TR 376, 378, 382).

Dr. Manley Shaw, appearing for Appellee, testified as to the incident following the February myelogram that the ordinary reaction to the myelogram dye is accompanied by severe headaches and elevation of pulse and temperature or respiration pulse (TR 187), and as to the nature of the pain in the legs, testified:

"Q. Are you able to definitely account for the leg pain?

"A. No, sir, this is conjectural.

"Q. Do you have an opinion as to the cause of that pain?

"A. I would judge because of the fact that it is aggravated by forward bending, that possibly the nerve roots are bound in adhesions. Whether this is related to the myelographic study or residual of injury, plus aging, plus postsurgical changes is conjectural at this time." (TR 180-181)

"A. I don't believe the fusion in itself is painful and this seems solid by x-ray at the present time. I don't believe the fusion per se is at fault, but this would seem to be some irritation of the nerve roots probably by scar formation and either progressive as a result of wear and tear, possibly some relation to the irritation of the dye, possibly some relation to the injury itself." (TR 195)

"Q. Now, doctor, in your present examination of him, you were still uncertain as to what the cause of his lower leg pain is?

"A. Yes, sir. In the absence of neurological changes, I believe this pretty effectively rules out the possibility of spinal cord tumor or a progressive arachnoiditis." (TR 186)

Dr. Kiefer in discussing the examinations he made of the Appellee in the summer of 1964 following all of the operations stated he found all of the neurological symptoms in the lower extremities to be normal, and that ". . . it is very unlikely . . ." (TR 307) that the patient could have developed arachnoiditis in a couple of hours after the myelogram ". . . because it takes time to develop scar tissue in arachnoiditis." (TR 307). He thought further the cramping of the legs indicated intermittent claudication (TR 304, 310). Dr. Kiefer

definitely ruled out arachnoiditis, as not verified by the symptoms and as extremely rare (TR 313). Likewise Dr. Coughlin, whose deposition was read by the Appellee, stated:

> "In my examination I considered the possibility of his having arachnoiditis. I felt that very probably he did not have it." (TR 279)

Dr. Shaw stated that the total number of accidents which Appellee had had were a "material" part of his present disability (TR 184), that his loss of hearing of forty-one percent in one ear and thirty-one per cent in the other (TR 184) would make it difficult for him to be alert and avoid dangerous situations (TR 193), and that the disability he found existing in the legs was a material part of the Appellee's inability to carry on his work. (TR 194). Dr. Raaf similarly stated that his previous osteoarthritis accounted for part of his present disability and that without it his neck symptoms would have subsided quickly after the accident (TR 373), that the residual difficulties on the lower legs were due to preexisting conditions (TR 376, 378,) and that the flare up of pain after the myelogram was for the previous operation for which fusion had been done. (TR 361, 362).

In any event, it appears from Appellee's testimony that whatever caused it was sudden, unexpected and apparently severe. Even Dr. Burton agrees that if it was the result of the myelogram it was highly unusual (TR 158) as, of course, did all the other doctors. Stepping out of bed through whatever mechanism acted caused this sudden, unusual and severe result. It is also uncontradicted that this last event, a separate incident, and one happening outside of the insurance

period, has only created a total disability of the Appellee, if he is totally disabled, because of accumulation. Thus, Dr. Burton stated:

> "My feeling on that would be that each succeeding accident, no matter who has it, each succeeding accident is going to leave its toll. There finally has to be one that is the straw that breaks the camel's back." (TR 168)

Dr. Shaw spoke much in the same terms:

> "Q. Doctor, if Mr. Thompson did not have what occurred after the myelogram, whether it is related to it or not I don't know, but if he didn't get this disability he presently has in his extremities, lower legs, would this affect your opinion?
>
> "A. He was working, I gather, in the same capacity as a working supervisor prior to this injury. In other words this seems to be the straw that broke the camel's back." (TR 193, 194)

Again, that the preexisting infirmities causing disability by accumulation with the present disabilities is shown by Dr. Raaf's testimony that the present symptoms in the lower extremities was due to injuries and conditions existing prior to the September 9 fall. (TR 376)

D. WHETHER APPELLEE IS TOTALLY DISABLED

If the injuries of the Appellee are within the provisions of the policy previously quoted, he is entitled to the payment for total disability as follows:

> "After one year of 'continuous total disability'

> and if the insured is then 'permanently and totally disabled' the company will pay a permanent total disability benefit . . ."
>
> " 'Continuous total disability' which must result from such injuries and commence within 365 days after the date of accident, means the insured's complete inability during the first year thereof to perform every duty of his occupation."
>
> " 'Permanent and total disability' means the insured's complete inability after one year of continuous total disability as defined above, to engage in an occupation or employment for which the insured is fitted by reason of education, training or experience for the remainder of his life." (R 37, 57; Exhibit 4, TR 57)

The statements that follow concerning whether he was totally disabled, do not concede from what source such disability may have arisen.

Following the cervical operation of February 28, 1964, the evidence is uncontradicted that he received considerable relief from the injuries from the September 9 fall. The evidence is uncontradicted that the laminectomy was the proper treatment, and that the removal of the lamina as opposed to attempting to remove the herniated cervical disc, was the conservative and proper way to handle the injury. There is no atrophy of any of the muscles involved which proves there was no damage to the motor nerves. Only slight damage was indicated to the sensory nerves due to a limited sense of feel on two or three fingers in the left hand and the lower side of the left forearm. Some

degree of limitation of motion in the neck existed, but whether it was due to the accident or preexisting conditions is uncertain.

The other areas of disability concern the major loss of hearing in both ears, a major disability rating concerning the burns on the hands from the fire of May, 1963, the considerable loss of motion in the low back from the 1948 fusion operation, the reduced vital capacity in the lungs, both from the fire of May, 1963, and preexisting conditions of some chronic bronchitis and emphysema and generalized hardening of the arteries and arthritis.

In relation to this health picture, the policy provisions require, after a year of continuous total disability, which is the inability of the Appellee to perform "every duty of his occupation," that Appellee be "permanently and totally disabled." Appellee to be permanently disabled, must be unable to engage in "an occupation or employment" for which he is reasonably suited by education, training or experience. The record shows that for a man of 55 years of age, Mr. Thompson is able to read, although he uses reading glasses, and has no trouble in writing letters and filling out forms. (TR 391.) He has been a supervisor at the intermediate level on heavy construction, supervising anywhere from 30 to 150 men, and has engaged in training men in the operation of equipment he used. He has had experience in South America as well as the near East, including dealing with foreign local officials. He is able to drive a car, he qualifies for a driver's license (TR 68) and is able to get around to such things as visiting for a few days at a cattle camp where his daughter and her husband worked (TR 71).

While living at Leadore in the severe winter, down to 35 degrees below zero, he was able to walk back and forth to the post office, a few blocks, to get the mail (TR 71, 73). He is able to dress and shave himself without any difficulty, other than trouble in getting his shoes and socks on. (TR 73) The evidence further shows the only employment he has tried to carry on since the accident of September 9, 1963, was in May of 1964 when he tried sweeping. Since that time he has made no application for any type of work and just drew unemployment compensation as long as he could (TR 74). He has no difficulty sitting for periods of time. There is nothing in the record that would show within the policy terms that there was no occupation or employment in which he could engage by reason of experience, training or education.

E. OTHER FACTUAL POINTS

The facts concerning other grounds upon which this appeal are based are set forth in the specification of errors or in the legal arguments concerning the individual points of procedure during the trial, instructions and motions.

III

QUESTIONS PRESENTED

The specifications of errors are set forth in Exhibit "A" hereto and made a part hereof. While the questions presented are more fully set forth in the summary of argument hereafter, the basic questions are as follows.

Did the Appellee meet the burden of proof to bring him within the coverage of the accident policy by showing that the bodily injuries caused by the accident of

September 9, 1963, were not within the exclusions of the policy for illness, disease and/or bodily infirmity, etc., and resulting directly and independently of all other causes from said accident?

If Appellee's proof meets said burden, did Appellee meet the burden of proof that after the existence of one year of continuous total disability commencing within 365 days after the accident of September 9, 1963, he was totally and permanently disabled from engaging in an occupation or employment for which he might be fit by reason of education, training or experience?

Was the action of the Court in ruling on evidence during the trial, and in ruling on the motions for voluntary dismissal, directed verdict, judgment notwithstanding the verdict, and new trial prejudicial error?

IV. SPECIFICATION OF ERRORS

The trial court erred in the following particulars:

1. The Court erred in denying the motion of Appellant for a directed verdict in favor of defendant and against the plaintiff, which motion is shown on TR 416-418, and including the grounds set forth on the motion of Appellant for involuntary dismissal as set forth at TR 283-288.

2. The Court erred in denying Appellant's motion for judgment notwithstanding the verdict, which motion is set forth at R 187 through 192, and denied by order of December 8, 1965 (R 217).

3. The Court erred in denying Appellant's alternate

motion for a new trial set out at R 194-200, by order of December 8, 1965, R 217.

4. The Court erred in giving Instruction No. 11, ¶ 2, TR 423, reading,

> "You are further instructed that legal notice and proof of loss were timely made,"

upon the grounds of objection that Appellant requested the wording of Requested Instruction No. 2, R. 155 (TR 423, line 10), both as to the twenty-days notice and as to the ". . . question about when the year actually starts," (TR 423) and the requested instruction desired was:

> "Finally, you must find plaintiff submitted written proof of loss within 90 days after the running of said full year of continuous total disability and after submitting proof of loss, did not commence any action in court until expiration of 60 days after such proof of loss." (R 155)

This was clearly error where the court in Instruction No. 13, ¶2, TR. 435, instructed as an issue for the jury that plaintiff had to prove the 365 days had elapsed after the accident, showing an issue of fact still existed as to whether or not the proof was timely (TR 435). The Court assumed the objection which had been made in prior argument (TR 423), which argument is set forth at TR 286-88, relating fully to whether the 20 days or reasonable time had expired after the loss had occurred and whether there had been an expiration of 365 days before the loss had occurred, before the proof of loss could be filed. This was error because of lack of evidence as to when the proof of loss was filed, and there was a jury issue, in any event, as to inferences

relating to that date and as to whether a full year of continuous total disability had expired; further the instruction totally left out a relationship between whether the full year had run and the date of the filing.

5. The Court erred in refusing to give Appellant's Requested Instruction No. 2, R 155, set forth above in Specification 4, on Appellant's objection as likewise set forth in Specification 4 immediately foregoing. The basis of the objection for not giving said instruction was that the Court did not instruct the jury properly on the relationship between the time for filing of the proof of loss and the expiration of the 365 days of total continuous disability (TR 423).

6. The Court erred in giving Instruction 13, ¶4, TR 436, reading:

> "In order to recover, the plaintiff must prove, by a preponderance of the evidence, as in these instructions defined, each of the following:
>
> ***
>
> 4. That such disability resulted directly and independently of all other causes from bodily injuries caused by the accident."

Appellant objected to this instruction at TR 424, requesting there be added thereto the disease and bodily infirmity portion of the exclusion clause of the policy, and secondly, that it could not include disability caused by another accident following the September 9, accident. These were denied by the Court, on the basis that: "I feel 'directly and independently' must be all inclusive," (TR 424, line 14), which is contrary to the policy wording.

7. The Court erred in giving Instruction 13, ¶¶2 and 3, TR 435-36, reading:

> "In order to recover, the Plaintiff must prove, by a preponderance of the evidence as in these instructions defined, each of the following:
>
> * * *
>
> 2. That the plaintiff became, continuously for three hundred and sixty-five days after said accident, so disabled as to be completely unable during said period to perform every duty of his occupation.
>
> 3. That the plaintiff became, within three hundred and sixty-five days after said accident, totally and permanently disabled from performing in the usual and customary manner an occupation or employment for which he is fitted by reason of his training, experience or education for the remainder of his life."

Appellant objected:

> "I think paragraph 2 of 13 and 3 should state the two differences. Paragraph 2 should be continuously totally disabled for the first year after the disability and paragraph 3 should be total disability thereafter." (TR 421)

Instead, paragraph 2 speaks of the three hundred sixty-five days without noting the proof of loss must come "after" it, and more seriously in paragraph 3 states the total and permanent disability can commence "within three hundred sixty-five days after said accident," which is contrary to the policy that it can only occur after said time.

8. The Court erred in failing to give Appellant's

Requested Instruction No. 4, R 157, which reads as follows:

> "I instruct you that the accident insurance policy which plaintiff is covered by does not cover losses or disabilities which are brought about either directly or indirectly, in whole or in part, caused by or resulting from any illness, disease, bodily infirmity or bacterial infection other than one as a consequence of a cut or wound in the accident. The policy insures only against disabilities resulting directly and independently of all other causes from bodily injuries caused by accident. I also instruct you that said policy of accident insurance would not insure plaintiff against any other accident occurring to him outside of the time the policy existed, September 1, 1963, to October 31, 1963.
>
> I further instruct you that before you may find for the plaintiff, you must find that any disability which plaintiff presently suffers falls within the coverage of the policy. I instruct you that the term 'bodily infirmity" as used in the policy means something more than minor and passing or transient disabilities which leave no permanent effect, but does include the disabilities which plaintiff suffered, if any, from previous accidents, illnesses, and supersusceptibility or allergies to drugs unusual to the average person. Such exception does include disease, which I instruct you is defined as an illness or sickness and includes a disturbance of any function or structure of any organ or part of the body. The exclusion, however, does not include a disease caused directly by the accident itself.
>
> Therefore, if you find from the preponderance of

the evidence that a disease or bodily infirmity existed as herein defined, and said items contributed, in whole or in part to the disability of plaintiff, you may not find for the plaintiff."

The error in failing to give this requested instruction is noted in the immediately foregoing specification, as being a misinterpretation of the policy to leave out the excluded items in determining the coverage of it from an accident.

9. The Court erred in giving Instruction 15, TR 437, as follows:

> "You are hereby instructed that the term 'accident' as used in the policy is defined as an act which is not natural or probable and should not reasonably, under all the circumstances, have been foreseen."

Appellant objected on the grounds that the definition of accident given deleted the last clause of Requested Instruction No. 5 and the Court refused to reinstate that deletion (TR 425). The grounds of the objection are that the definition as given is quoted from the Idaho Supreme Court Opinion in *O'Neil v. New York Life Insurance Company*, 65 Idaho 722, 152 P.2d 707 (1944).

10. The Court erred in not giving Appellant's Requested Instruction No. 5, R 158, as follows:

> "You are hereby instructed that the term 'accident' as used in the policy is defined as an act which is not natural or probable and should not reasonably, under all of the circumstances, have been foreseen, and is tragically out of proportion to the trivial cause."

The last clause of this was requested to be inserted in the instruction, and was specifically rejected (TR 425). The grounds for its being inserted are given in Specification 9 immediately foregoing.

11. The Court erred in giving Instruction 16, TR 437, as follows:

> "Evidence has been received of injuries suffered by the plaintiff prior to the accident of September 9, 1963. You may consider this evidence in determining whether or not the disability claimed by the plaintiff resulted directly and independently of all other causes."

Appellant objected that this instruction was inadequate because it left out the exclusion words of the policy and requested that they be added. The Court rejected the same (TR 425). These exclusionary words should have been incorporated herein in order that the jury would have the correct definition of the policy's coverage.

12. The Court erred in rejecting Appellant's Requested Instruction No. 6, R. 159, as follows:

> "I instruct you that even though you may believe from the evidence the plaintiff suffers disability from the cervical spine injury of September 9, 1963, yet, if you further find from the evidence that the present disability suffered by the plaintiff results from a combination, concurrent and working together with disease or bodily infirmity not caused by the accident of September 9, 1963, whether existing before or after the September accident, the court then instructs you that you cannot find for the plaintiff in this case, because the disabilities of the

plaintiff, if any, are not within the terms of the policy."

This was rejected by the Court's notation on the record, R. 159, and is included in the request of Appellant in objecting to Instruction 16 because of the words left out of such instruction. It includes also the running objection of the Appellant referred to by the Court at TR 423, lines 21-23, and included Appellant's objections as noted in TR 424, lines 9-11. The request should have been granted in order to advise the jury of the relationship of the accident of September 9, 1963, and the prior or later diseases and bodily infirmities.

13. The Court erred in giving Instruction 17, TR 437, reading as follows:

> "If you find that the plaintiff suffered an accident on September 9, 1963, resulting in injury to his cervical spine, you are instructed that the plaintiff was under an obligation to submit to reasonable medical treatment in order to alleviate the injury and minimize the possibility of any disabling effects therefrom."

Appellant objected to this instruction at TR 425, stating: "There must be added to it that the Appellant is not responsible if in normal treatment bizarre and unusual results occur," but the Court rejected the request. As Appellant clearly is not liable for unusual results of medical treatment, or for unrelated accidents that may have happened during medical treatment, the instruction is misleading without the additional provision.

14. The Court erred in rejecting Appellant's Requested Instruction No. 8, R. 161, as follows:

> "If you find from the evidence that Plaintiff did sustain an injury to his neck on September 9, 1963, as alleged, and that thereafter in the treatment of such injury he was given a myelogram on February 21, 1964, after which he suffered a violent, unusual, unexpected and untoward result which caused disability in the lower extremities of plaintiff, which contributed and joined with the neck injury of plaintiff to cause his present disability, in such event plaintiff is not entitled to recover and your verdict should be for the defendant.
>
> "If you find, however, from all the evidence, that the myelogram did not result in any unusual, untoward or unexpected results in causing the disability of the lower extremities and that such disability as a result of a myelogram could be reasonably expected to develop as a result of the injury to the neck, and was not due to any disease or infirmity of plaintiff, then I instruct you that the development of the disability to the legs as a result of the myelogram are neither causes of the injury nor disease or bodily infirmity excluded from the coverage of the policy, and you may hold a verdict for the plaintiff."

Appellant objected to the failure of the Court to include the provisions of the first paragraph of Requested Instruction 8, in both Instructions No. 17 and No. 18, TR 425, dealing with normal medical treatment in relation to the cervical spine and the myelogram being necessary to deal with the injuries of the cervical spine. Specifically in objecting to Instruction 18, the Appellant requested there be added to it word-

ing that "If the result then is unusual and bizarre, it would not be within our responsibility." (TR 425, line 24.) These requests were in effect the wording of the requested instruction and were required by Idaho law concerning the results of medical treatment.

15. The Court erred in giving Instruction 18, TR 437-8, as follows:

> "If you find that in February, 1964, the plaintiff underwent myelographic studies and a surgical operation of a cervical spine and that such myelographic studies and surgical operation were from a medical standpoint necessary to deal properly with the effects of the injuries suffered by the plaintiff on September 9, 1963, and if you further find that the effects of either the said myelographic studies or surgical operation resulted in or contributed to plaintiff's present disabilities, you are instructed that the consequence following from the myelographic studies and the surgery are to be regarded by you the same as though they had followed the injury of September 9, 1963, without any intervening medical treatment or surgery."

Appellant objected to this in total (TR 425), and requested the additional provisions noted in the immediately foregoing Specification as to unusual and bizarre results from treatment. It is contrary to law to hold the Appellant liable within the policy for unexpected and unusual results of even normal medical treatment, aside from ones which may be caused by preexisting disabilities.

16. The Court erred in refusing to give Appellant's

Requested Instruction No. 7, R. 160, reading as follows:

> "I instruct you that even though you may find from a preponderance of the evidence that the Plaintiff is permanently and totally disabled at the present time, nevertheless you must further find from what sources said disability arose. Testimony has been presented in this case that Plaintiff suffers from disability arising from injuries suffered from the accident of September 9, 1963, during the period in which the accident policy existed and from an event which the jury could find to be an accident, and testimony has been presented that the present disabilities of the Plaintiff, if any, could also have come from causes excluded from the coverage of the policy; and testimony has been given from which the jury could find that the present disability of Plaintiff resulted from a combination, concurrence, and working together with causes from the September 9, 1963, accident within the coverage of the policy and causes excluded from the policy.
>
> Therefore, the Court instructs the jury that if you find as a fact that the disability of the Plaintiff resulted from a combination, concurrence and working together of causes within the coverage of the policy of insurance and causes excluded from the coverage of the policy of insurance, the court instructs you that Plaintiff is not entitled to recover in this action."

This is the basic matter which was urged upon the Court in each instance relating to the 'directly and independently of all other causes' clause, and rejected each time by the Court. (TR 424, lines 10 and 14) The jury was not properly instructed to consider whether or not the reaction to the event of February 21, 1964,

was a normal and usual thing or a violent, unsual and unexpected thing. The law required that they be so instructed. The Court rejected it by so marking it.

17. The Court erred in Instruction No. 10 in ¶ 2, TR 433, reading as follows:

> "The Defendant denies that Plaintiff is entitled to the benefits of the policy, contending that Defendant is not totally and permanently disabled; that even if he were, such disability did not result directly and independently of all other causes from bodily injuries caused by any accident occurring while the policy was in force. Defendant contends that disability, if any, arose in part from preexisting bodily infirmities of Plaintiff. Alternatively, Defendant contends that if the result of the diagnostic treatment of the Plaintiff on February 21, 1964, by way of a myelogram, materially contributed to plaintiff's disability, that such event constituted an accident and that such accident occurred after the insurance coverage was discontinued."

Appellant objected that it was not the diagnostic treatment, it was the unusual result which was contended to cause the disability, to which the Court said: "I will put those words in." (Tr. 422, lines 18 and 23) Appellant also objected that the instruction used the word that the event constituted "an accident" and there was confusion as to which accident might be referred to. Appellant requested an additional word "another" accident. The Court denied this. (TR 423, line 4) It was material error to mislead the jury in stating the Appellant's contentions were that the myelogram materially contributed to the disability.

18. The Court erred in rejecting evidence offered on behalf of Appellant, to wit:

(a) Appellant asked Appellee under cross-examination what he received in pay while working on the Iran job. Appellee's counsel objected that it was not material or relevant. (TR 389) The Court sustained the objection (TR 390) Appellant made an offer of proof quoting from a previous deposition of Appellee, which offer was rejected by the Court without further objection from Appellee's counsel. (TR 396) The evidence shows a substantial salary was received by Appellee, and this was material and relevant in judging the ability of the Appellee to carry on other work. It clearly showed his abilities were not related mainly to manual labor as was sometimes implied in the case. It was material error.

(b) Appellant asked Appellee on cross-examination if he was still of the opinion as set forth in the verified complaint, Exhibit 12, that his present disability arose immediately after the accident of September 9. Appellee's counsel objected without stating any grounds because of the Court's interruption and the Court sustained the objection. (TR 85-86) Verified pleadings certainly can be used to impeach or refresh the memory of a witness, and preventing the Appellee from answering was material error.

(c) Appellant asked the Appellee to read Exhibit 10, the amended claim to the Industrial Accident Board of the State of Idaho as to the 1963 injury, and as to paragraph 7 on page 3 to say whether he still agreed with what was set forth there. Appellee objected without stating any grounds because of the interruption of

the Court (TR 84, line 21), the Court stating the grounds he wanted and requesting the Appellee to make objection on those grounds. Appellee did so and was sustained. (TR 85) This was substantial error as the pleading of the Appellee on the same accident in a different form which substantially and materially contradicted his present testimony was certainly proper at least for impeachment purposes. The Industrial Accident amended claim clearly set forth that the present disability of the plaintiff was in part an accumulation from prior accidents.

19. The Court erred in admitting into evidence Exhibit 20 offered on behalf of Appellee, a report of medical examination made by Morrison-Knudsen Co. for its own purposes. Appellant objected that because of lack of identification by the person having control and custody of it, it was hearsay (TR 244), that it was prepared wholly in relation to other matters not binding on Appellant and was irrelevant and immaterial (TR 245), and that there was no evidence that it represented the complete report of the doctor as it may have existed in the files of the company (TR 246). The Court admitted the exhibit after the Court remarked three times to the effect that Appellant's objections were going to make the Court have to take a recess to find the proper officer, after the Court commented on the contents of the exhibit, and after the Court asked the witness questions trying to lay a sufficient foundation for placing it in the record. Further, no evidence was offered as to the position of the medical examiner with the company or the procedure by which the document reached the files, if it did, of the company. Appellant was prejudiced by the content of the exhibit, the Court's comment upon its content to the

jury, and the Court's remarks to Appellant concerning objecting to it.

20. The Court erred in rejecting exhibits offered on behalf of Appellant, to wit:

(a) Appellant offered Exhibit 12, the verified complaint, particularly paragraph III thereof. Appellee's objection gave no ground, but the Court sustained the objection raised and provided the grounds as irrelevant and incompetent. (TR 86) Appellant offered it to show prior inconsistencies.

(b) The Appellant offered Exhibit 10, paragraph 7 thereof, which exhibit was a copy of the amended claim of the Appellee to the Industrial Accident Board of Idaho concerning the Sepember, 1963, injury. Appellee commenced to state an objection, the Court interrupted and provided the basis for it, and then sustained the same. (TR 84-85) Authenticity was stipulated, and the document was relevant and material as it related to the same accident involved in the case, and certainly was material for impeachment purposes on a prior inconsistent statement.

(c) The Appellant offered Exhibit 8, 9 and 11, being respectively documents concerning the 1960 industrial accident, the 1962 industrial accident, and the 1953 industrial accident of Appellee, giving the lump sum settlements and other details of disability in each case. (TR 82) The Court had already stated that he did not believe the records were pertinent (TR 81, line 15) and that "We have your objection to this entire line of testimony, but with that objection in mind can we get an agreement as to the percentage of disa-

bility?" (TR 81, line 33) Counsel then objected that they were hearsay, even though it is stipulated they are authentic (TR 81, R. 62-63). The Court rejected these documents, and that is error despite the fact that the percentage of disability was stipulated, in that the details of the accident and the actual award were not before the jury.

21. The Court committed substantial error by not maintaining an impartial attitude during the trial as to such matters as: stating the grounds of objection for the Appellee (TR 86); interrupting Appellant's questions before an answer could be given and commencing asking them himself (TR 50); interrupting Appellant's cross-examination of Appellee purportedly to keep out in advance otherwise inadmissable evidence and without objection by Appellee's counsel (TR 50); cutting off a preliminary objection by Appellee to state the grounds he believed would be proper for such objection with the request that Appellee make such objection (TR 84); suggesting to Appellee's counsel how to reword an objectionable question without sustaining Appellant's objection to it (TR 117-118, 405); interrupting Appellant's cross-examination of a doctor with reference to questions asked two or three questions back and stating the question was not a fair one when no objection had been made by Appellee (TR 192-193); suggesting to Appellee's counsel that he ought to explore a little further the question of foundation for admission of an exhibit after Appellant's objection (TR 241, line 9); in relation to Exhibit 20, criticizing Appellant's objections for delaying the trial by asking that a proper person identify the exhibit, participating actively in trying to qualify the exhibit for admission by asking questions, commenting on the

exhibit's content, and suggesting to Appellee how to proceed (TR 244-246); and participating in the questioning of one of Appellee's witnesses by restating the Appellee's question (TR 241, line 18), not ruling on Appellant's objection to the question and rewording it for the Appellee (TR 241, line 25). Because the Court did not give the same aid to Appellant and its witnesses, it was clear to the jury that the Court was critical of Appellant and favorable to the Appellee. He did not maintain an impartial attitude by his one sided participation in the trial.

22. The Court erred in interpreting the accident insurance policy under the "directly and independently of all other causes" clause as including the exclusions of losses caused by or resulting from illness, disease or bodily infirmity, thus denying the motion for directed verdict and for judgment nothwithstanding the verdict on the theory proximate cause had been proven whereas the policy required sole cause if the excluded items were involved.

23. The Court erred in not granting the motion for new trial based upon the errors set forth herein in Specifications 4 through 21, and for trying the lawsuit on the incorrect theory as to the "directly and independently of all other causes" clause, leaving out the exclusionary provisions of the policy in the jury's consideration.

24. The Court erred in denying the motions for a directed verdict, for judgment notwithstanding the verdict, or in the alternative for a new trial in that Appellee did not establish proof of loss was made after

the three hundred sixty-five days of continuous total disability from "such injuries" which could only refer to those resulting directly and independently from all other causes and not within the excluded items, the evidence being uncontradicted that pre-existing disease and bodily infirmity contributed to his condition during the first year and that the event of February 21, 1964, was a new efficient and intervening cause within such definition. Further, no written proof of loss was filed in accordance with the provisions of the policy within ninety days after the loss, which was a condition precedent to recovery and which loss had not occurred at the date of the filing, as argued to the Court on motion for involuntary dismissal (TR 285) and directed verdict (TR 416).

25. The Court erred in not granting the motion for directed verdict or the motion for judgment notwithstanding the verdict in that there was insufficient evidence to determine the date the notice of claim or the proof of loss was filed with Appellant, which filings were condition precedent to action herein, the only matter of record being the pre-trial order that they were received "on or about" September 9, 1964. This was argued to the court on motion for involuntary dismissal (TR 287) and on motion for directed verdict (TR 416).

26. The Court erred in denying the motions for a directed verdict and for judgment notwithstanding the verdict in that the evidence was insufficient for the jury to be able to determine that Appellee was permanently and totally disabled within the definition of the policy and that such disability existed after one year of continuous total disability, the evidence being

uncontradicted that none of the doctors was willing to say that wholly apart from the pre-existing bodily infirmities and wholly apart from the disabilities from the February, 1964, incident, Appellee was totally disabled. This was argued in motion for directed verdict (TR 416), including grounds argued for involuntary dismissal (TR 285), and in the argument on the motion for the judgment notwithstanding the verdict.

27. The Court erred in denying the motions for involuntary dismissal, directed verdict and judgment nothwithstanding the verdict in that the evidence conclusively shows the substantial degree of the Appellee's present disabilities were related to the incident of February 21, 1964, when Appellee stepped out of bed, in that such results were due to a highly unexpected, unusual, and severe reaction tragically out of proportion to its cause, so as to be considered an accident, and that said disability resulting therefrom could not be within the definitions of the insurance policy. This was argued to the Court on motions for involuntary dismissal at TR 285, directed verdict at TR 416, and judgment nothwithstanding the verdict at R. 187, et seq.

28. The Court erred in denying Appellant's motions for involuntary dismissal, directed verdict and judgment notwithstanding the verdict, as the evidence was clear that Appellee had not met the burden of proof by a preponderance of the evidence that the loss claimed from the accidental injury was not excluded by the exclusions of the policy as being due to illness, disease and bodily infirmity, the preponderance of the evidence clearly showing that Appellee's present disability is to a substantial portion due to the excluded items.

V ARGUMENT

SUMMARY OF ARGUMENT

Appellant's position is that any loss from disabilities of Appellee did not result directly and independently of all other causes, excluding any loss caused by or resulting from illness, disease or bodily infirmity, from bodily injuries caused by the accident of September 9, 1963; that the loss from disabilities of the Appellee was caused by or resulted from preexisting disease and bodily infirmities which are excluded from coverage by the policy; and that a substantial portion of the loss of Appellee from disabilities is due to an accident occurring outside of the coverage of the policy. Appellant further contends that Appellee has not met this burden of proof in establishing evidence sufficient to bring him within the policy as to the loss alleged, has not met his burden of proof in establishing that he was continuously totally disabled for one year after which he then filed his proof of loss; and that he has not met his burden of proof that he is permanently and totally disabled as not to be able to engage in any occupation or employment for which he is fitted by reason of education, training or experience for the remainder of his life. Appellant further contends the Court below committed substantial error in rulings on evidence, in the instructions given and refused, and in the prejudicial remarks and actions of the Court during the trial. For one or more of these reasons, the Court erred in refusing Appellant's motion for dismissal, motion for directed verdict, motion for judgment notwithstanding the verdict, and motion for new trial.

A. THE POLICY OF ACCIDENT INSURANCE

The policy of insurance of Appellant herein is an

accident policy providing specific indemnity for loss of life, limb or sight, or total disability. Any salaried employee after 90 days employment with the named companies was eligible to be insured under it, and the Appellee did apply and obtain coverage at the cost of $6.25 a month for the two months covered. The words of coverage and the exclusions from coverage must be carefully considered, for as it has been stated:

> "Insurance against death by accident is usually afforded for a small premium, and the coverage is correspondingly narrow. The liability is guarded by carefully chosen words. The courts have no more right to strain construction to make the policy more beneficial by extending the coverage contracted for than they would have to increase the amount of the insurance." *Davis v. Jefferson Standard Life Insurance Company*, 73 F.2d 330 (CCA 5th 1934) cert den. 294 U.S. 706, 79 L.Ed. 1241.

The policy clearly covers an incident caused by accident while the policy is in force for bodily injuries resulting directly and independently of all other causes from said accident. The policy specifically excludes, as distinct from excepts, any loss caused by or resulting from illness, disease, bodily infirmity, and other items. Its meaning can be determined by examining the facets of the policy, which are (a) an accident, (b) while the policy was in force, (c) the loss resulting directly and independently of other causes from the accident, (d) the loss is not caused by or result from the excluded items, (e) the definitions as to one year total continuous disability and the total permanent disability thereafter set forth in the policies have been met, and (f) proper proof of loss as a conditioned precedent has been made.

There is no issue as to the policy being in effect when an accident occurred to Appellee on September 9, 1963. Therefore, the first two points are covered.

The definition of accident becomes important because of the subsequent event of February 21, 1964, when on stepping out of the bed, Appellee claims a further and much more serious disability occurred. The same is outside the period of coverage of Appellant's policy and Appellee has sought recovery herein on the apparent theory that the subsequent event was not a separate, distinct accident, or a substantial intervening cause or excluded cause, but was merely a normal result of the earlier accident.

The courts of Idaho have defined an accident as an event where the results of an act were not natural or probable and could not be reasonably, under the circumstances, forseen, and are tragically out of proportion to the trivial cause. *O'Neil v. New York Life Insurance Company*, 65 Idaho 722, 152 P.2d 707 (1944). It is similarly stated that an accident ". . . is used in the . . . popular and ordinary sense is denoting an unlooked for mishap or untort exent not expected or designed." *Wilson v. New York Life Insurance Company*, 82 F. Supp. 292 (DC Idaho), Aff'd 178 F.2d 534 (CCA 9th, 1949). It is generally defined as:

> ". . . (A)n event which takes place without one's foresight and expectation, that is, a casualty—something out of the usual course of events—which happens suddenly and unexpectedly, without any design on the part of the person injured, and it is not the natural and probable consequence of an ordinary or common act, as distinguished from an event the occurrence of which involves no element of chance

or unexpectedness." 10 *Couch on Insurance*, 2d, Sec. 41:7, pp. 29-30 (1962).

Next subject for definition is the "resulting directly and independently of all other causes" from injuries caused by the accident and it relationship to the exclusion, that such loss may not be caused by or result from, among other things, illness, disease or bodily infirmity. If a policy contains only the first directly and independently clause, the general interpretation indicates that the accident has to be the efficient, substantial and proximate, but not necessarily the sole, cause of the disability at the time it occurs. The additional policy clause of exclusion for a "loss" caused by or resulting from a number of specified items limits the general applicability of the first clause, and in effect requires that a loss from an accident is not insured against even though the accident is the proximate cause if it acts in conjunction with such excluded items. The mere existence of disease, illness or bodily infirmity which does not act in a causal relationship with the loss from the accident would not limit the proximate cause definition. Likewise, such clause means that the excluded causes of loss can either be indirectly or partly responsible for the loss, because otherwise the accidental loss would not directly and independently of all other causes. The great weight of authority sustains these holdings.

The first exclusion of a loss "caused by" disease or infirmity means an accident contributing to or cooperating with the disease or infirmity to create the disability creates no loss under the policy. *Liberty National Life Insurance vs. Bailey*, 34 Ala. App. 199, 38 S.2d 295. The phrase of a loss "resulting from" a disease

or bodily infirmity means loss claimed under the policy may not arise by concurrent action between the accidental injury and a disease or bodily infirmity, such as where the accidential injury aggravates a preexisting disease or bodily infirmity and actually contributes to the ensuing disability. *Maryland Casualty Co. v. Morrow*, 213 Fed. 599, 52 LRANS 1213; *Herthel v. Time Insurance Company*, 221 Wis. 208, 265 N.W. 575 (1936); *First National Bank v. Equitable Life*, 225 Ala. 586, 144 So. 451.

The facts in the latter case are a good example of this, wherein the insured died as a result of a blow to the head caused by an accidental fall, death arising from meningitis superimposed upon the rupture of an existing brain abscess. Evidence disclosed the abscess in the brain was caused by an old injury with adhesions to the skull, and the blow to the temple of the insured in his fall ruptured the abscess with the infection following therefrom. Recovery was denied with the court giving a good analysis of the general law, among other things stating:

> "It seems, therefore, the great weight of authority supports the views expressed in our cases, vix. where there is special provision directing the attention of the insured to disease or bodily infirmity, and expressly including liability in case of death resulting directly or indirectly therefrom, some effect must be given to these provisions . . . The application of the principle of law to the case at bar is that, if the insured was suffering from a disease, which was accelerated and aggravated by the accident so as to be a cause cooperating with it to produce the fatal end, then there can be no recovery . . ." 144 So. at 454, 455.

The confusion that some courts have found, contrary to the weight of authority, in dealing with the exclusion provision in relation to the directly and independently of all other causes provision is noted in the case of *Russell v. Glenn Falls Indemnity Company*, 134 Neb. 631, 279 N.W. 287 (1938) where the court had before it a policy involving the "independently and exclusive of all other causes" clause together with an exclusion for disability caused by bodily infirmity or disease. In the case where disease added to the effect of an accident caused total disability, the Court stated:

> "One source of confusion in the decisions on this question in the different courts, even in the same jurisdiction, is in applying the reasoning and law of one case, based on certain insurance contract providing for benefits resulting from accident, to another case with a different contract. Many of the cases are where contracts involve only the provision 'resulting directly, independently and exclusive' while others have the additional clause 'wholly or in part, directly or indirectly from disease or other bodily infirmity or other disease' or a phrase of a like nature. There is clearly a distinction between the two contracts . . .
>
> "It seems reasonably clear that a policy with the phrase 'resulting directly, independently and exclusively' refers to the efficient, substantial and proximate cause of the disability at the time it occurred. On the other hand, a policy which also has the phrase 'wholly or partly, directly or indirectly, from disease or mental or bodily infirmity' refers to another contributory cause, whether proximate or remote." 279 N.W. at 291

An example of this is the case of *Beams v. John Hancock Mutual Life Insurance Company*, 325 F.2d 887 (CCA 6th) where some three months before the accidental fall of the insured he had had gall bladder troubles and the fall caused gall stones to obstruct the ducts, requiring surgery which caused complications and death. The court held death resulted from the combination of the fall and the gall bladder condition and allowed no recovery for accidental death in view of the additional exclusion of death caused by disease or bodily infirmity. Similarly in the case of *Welte v. Metropolitan Life Insurance*, 305 Ill. App. 120, 27 N.E. 2d. 63, where the death of the insured from bronchopneumonia followed an operation necessitated by a duodenal ulcer rupturing, where the rupture was caused by accidentally slipping and falling, recovery was denied because the death was not "directly and independently of all other causes from bodily injury" from an accident where the ulcer is not a normal part of a person's anatomy, but is a disease or bodily infirmity and contributed directly to the disability suffered.

The exclusionary clause applicable here, excluding loss caused by or resulting from illness, disease, bodily infirmity or bacterial infection other than from the accident, is similar to those construed in a number of cases. The Idaho law is set forth in *Rauert v. Loyal Protective Insurance Company*, 61 Idaho 677, 106 P.2d 1015. That policy excluded from a loss caused by accident anything due to a disease. Where the insured had had an earlier hernia operation which had resulted in a ring of adhesions, and a second hernia operation took place which resulted in strangulation of the hernia due to adhesions from the earlier op-

eration causing the death of the insured, the testimony showing that the fibrous condition was not "a disease," the verdict for the insured was allowed to stand. The forming of such adhesions and scar tissue were specifically held not to be a disease, based on the doctors' descriptions of it, one of whom called it an "unsound condition," and another referring to the adhesions as resulting from prior operation as infirmities. 106 P.2d 1015. This allowed the Idaho Court to find for the insured, but the need to make the strained construction of the policy exclusion is a holding that if the word "infirmity" had been present, no recovery would have been allowed.

Many of the cases, however, make little distinction between disease, and infirmity, such as Chief Justice Cardozo in *Silverstein v. Metropolitan Life*, 254 N.Y. 81, 171 N.E. 914 at 915, where he defines both as:

> ". . . a morbid or abnormal condition of such quality or degree that in its natural and probable development it would be expected to be a source of mischief, in which event it may fairly be described as an illness or infirmity."

Cases specifically hold that bodily infirmity comprehends abnormal weaknesses of the body. Thus *New York Life Insurance Co. v. Bruner*, 129 Ind. App. 271, 153 N.E. 2d 616 (1958) holds where the insured voluntarily consented to the administration of a spinal anesthetic, which was properly administered, and the insured died as a result of supersusceptibility, no recovery was allowed as the death was not directly and independently of all other causes from accident as opposed to infirmity or illness. That case cites *Davis v.*

Jefferson Standard Life Insurance supra, which holds that bodily infirmity includes such abnormal weaknesses as well as acute diseases. The exception, nevertheless, does not require the insured to be in perfect health, and the exclusion does not include mere frail general condition or a mere tendency to a disease. 10 *Couch on Insurance*, 2d, Sec. 41:384, p. 351 (1962), and cases cited.

It is immaterial under the type of policy here whether the disease or bodily infirmity incurred prior to or after the issuance of the policy as long as neither was directly caused by the accident. *Lado v. First National Life Insurance Co.*, 182 La. 726, 162 So. 579; *Moore v. Southern Life & Health Co.* (La. Ct. of App.), 195 So. 857. In effect there can be no recovery for the insured's loss, whether a disability or a death, under this type of policy results from an accidental injury acting in conjunction with a preexisting bodily infirmity. *Rhoda v. Metropolitan Life Insurance Company*, 354 Pa. 313, 47 A.2d 152. Where a preexisting infirmity exists which cooperates with or contributes to the accidental injury, no liability can exist under such policy for accidental injury solely, independently and exclusively from the cause, with the exclusion as noted in this case. *Liberty National Life Insurance Co. v. Bailey*, supra.

It is clear from the policy before the court that the exclusion clause demands more than the accident be the "approximate cause" in that the loss cannot be from an accident in conjunction with or aggravated by the excluded items. The balance of the definitions in the policy, concerning permanent and total disability and concerning proof of loss will be discussed in the arguments on these points.

B. BURDEN OF PROOF UNDER POLICY

The specific wording of the accident policy determines the burden of proof here. The burden is on the Appellee as plaintiff to show that the bodily injuries for which a loss is claimed were caused by accident resulting directly and independently of all other causes and even so not including the excluded cause in any degree. It is undisputed that this requires him to show approximate cause in the sense used in insurance policies.

The dispute arises concerning the burden of proof in relation to the excluded items. The Idaho court has recently definitely determined this question. In *Evans v. Continental Life & Accident Co.*, 88 Idaho 254, 398 P.2d 646 (1965) under a group insurance policy containing accidental death provisions, and containing exclusions relating to coverage by Workmen's Compensation law and from disease of the body or mental infirmity, as well as the clause of "independently of all other causes," the court placed the burden on the plaintiff. It specifically held that the burden was on the plaintiff to avoid the excluded items in order to recover on the accidental portion of the policy. The case quotes with approval from *New York Life Insurance Co., v. McNeely*, 52 Ariz. 181, 79 P.2d 948 (1938) as follows:

> "It will be seen by referring to the double indemnity provision above set forth, that it is payable only on proof that the death of the insured resulted directly and independently of all other causes from bodily injury affected solely by external violent and accidental means. Under provision of this kind, it is necessary not only that the beneficiary of the policy prove the death of the insured, but also prove affirm-

> atively, by a preponderance of the evidence, that such insured came to his death by reason of the specific cause as set forth in the policy, and from those causes only . . ." 79 P.2d at 948

The reasoning of the *McNeely* case thus adopted by the Idaho court is set forth more clearly at page 952 of 79 P.2d, where the court emphasizes the distinction between accident policies with exclusions, and other types of policies such as life insurance with exceptions. It quotes with approval as follows:

> "The differences that have arisen as to which party bears the burden of persuasion in insurance cases, when the defense is based on suicide, have been caused in part by a failure to distinguish between cases in which the plaintiff sues on an accident insurance policy or the double indemnity clause of the life insurance policy, and cases in which the insurer in a life policy raises the defense of suicide. If death from any cause except suicide is insured against, the burden is on a company to prove the exception; but if death from one specific cause, such as accident, is insured against, the burden is on the policyholder to show the condition precedent to liability has taken place . . ."

The only difference between the policy of the *Evans* case and the present policy is that the particular exclusion which was involved was whether the accident was covered by Workmen's Compensation. The court held that the plaintiff beneficiary had the burden of proving that the exclusion of workmen's compensation coverage did not apply to the accident and held for the defendant on failure of proof. An exclusion for disease or infirmity was also listed in the same area of the

policy in the Evans Case. Therefore, the same logic is applicable to our case as to the exclusion there.

That the burden to avoid the exclusion is on Appellee is made very clear by the Idaho Court quoting from *Metropolitan Life Insurance Company v. Rosier*, 189 Okla. 448, 117 P.2d 793 (1941), where a nearly identical policy is involved. There the coverage was for a loss directly and independently of all other causes as well as the specific exclusion if "caused by or contributed to . . . by disease, or by bodily or mental infirmity." 117 P.2d at 794.

The Evans Case also quotes the case of *Washington National Insurance Co. v. Chavez* (Tex. Civ. App. 1937), 106 S.W.2d 751, approving the holding that:

> ". . . a plaintiff suing on an accident insurance policy has the burden of pleading and proving that insured's death was accidental and not within exceptions . . ."

A typical case is *Lucas v. Metropolitan Life Insurance Co.*, 339 Pa. 277, 14 A.2d 85, 131 A.L.R. 235 (1940), where the court states:

> "Where the liability of the insurance carrier is so restricted, [by the exclusionary clause plus the general clause] it is not sufficient for the insured to establish a direct causal relation between the accident and the loss or disability. He must show that the resulting condition was caused solely by external and accidental means, and if the proof points to a preexisting infirmity or abnormality which may have been a contributing factor, the burden is upon him to produce further evidence to exclude that possibility." (item added)

Clearly the Idaho court under its recent case has in effect said that where a loss from accident is insured against, the burden of proof is on the plaintiff to show that it was totally accidental as to the excluded items. As we will argue below, Appellee has not done this.

The other definition items, on total disability and as to the proof of loss, will be discussed in the legal argument on them below.

C. IS APPELLEE'S CLAIM WITHIN THE POLICY

This section of the argument discusses the sufficiency of the evidence under the applicable law in relation to the court's denial of Appellant's motion for a dismissal at the end of Appellee's case, for a directed verdict, for a judgment notwithstanding the verdict, and for a new trial in relation to the merits of the action apart from the alleged errors of the court on evidence and instructions set forth below.

Appellee has failed in his case in three particulars. He has not established by a preponderance of the evidence that the disabilities suffered by Appellee today resulted directly and independently of all other causes from the accident of September 9, 1963, and in fact the evidence is clearly to the contrary. Many infirmities existed prior to the accident in September of 1963.

Dr. Kiefer's operation in February, 1964, proved two infirmities existed, one being a hard boney ridge of protruding herniated disc, as opposed to a fresh juicy one, and the other was osteophytes at both the C-6th and 7th level operated. The testimony is uncon-

tradicted that neither the hard, boney, herniated disc nor the existing osteophytes could have been created by the accident some four months prior, and that it would have taken anywhere from three to ten years for them to develop. The evidence is uncontradicted that the pain in the neck and head as well as the radiation of it into the shoulders and left arm came from the impingement on the nerve caused by a vice effect between the vertebrae as enlarged by the osteophytes and the protruding hardened disc, which the accident of Sepember 9, 1963 aggravated. The evidence is uncontradicted that but for the existing osteophytes and hard protruding disc the symptoms from the injury of September 9, 1963, would have ceased in a few months. Both the operating physician, Dr. Kiefer, and Appellee's witness, Dr. Shaw, believe that substantial relief had been obtained from the symptoms in the cervical spine by the operation of February, 1964. While Appellee's witness Dr. Burton did not so agree, Dr. Shaw and Dr. Kiefer both were of the opinion that as far as the cervical spine was concerned, Appellee could return to work.

The material point is that the osteophytes, the hardened protruding disc C-7th level, the indicated protruding but symptomless herniated disc at the C-6th level, and the well recognized increased arthritis from previous injuries all existed prior to the September accident, and are clearly "bodily infirmities" within the policy definition. They related directly to the neck problem. They are bodily ailments of an established character not usually found in an average person which were aggravated by the accident and worked in conjunction with it.

Appellee at the time of the September accident also

suffered from disabilities in the lower back primarily resulting from the severe accident of November 1947, by an injury of October, 1952, by injury of November, 1955, an injury of October, 1961, and the injury of June, 1962. It was uncontradicted that such prior fusion operation and the disability relating to it could at any time thereafter cause him considerable trouble, lead to greater strain and wear on the joints above the fusion, and was clearly a chronic condition. If the leg disability is related to the September accident, this prior infirmity directly related, also, and again, this is a bodily infirmity within the exclusion of the policy.

Appellee had other disabilities. His loss of hearing was extensive. His vital capacity had been reduced by the accident of May 24, 1963, together with heavy smoking and incidences of chronic bronchitis and emphysema, by approximately 40%. Dr. Burton stated this could cause the pain from lack of circulation in the lower extremities (TR 159-160). Dr. Burton also rated the burns which Appellee suffered in the May fire as on the right hand 50% of loss of the hand at the wrist and on the left hand at 15% of the loss of the hand at the wrist (TR. 136-7). The Appellee himself testified he had been somewhat short of wind ever since the fire of May, 1963.

Appellee's evidence could not distinguish the disability from the September 9 accident from the previously existing bodily infirmities, and in fact the evidence is clear cut that there was a complete interaction between the pre-existing disabilities and the accident to create the symptoms that continued prior to surgery, and such residual as existed after surgery. These pre-existing disabilities acted in a major way, not

in an extremely remote and unconnected manner, with the blow received in the fall in September, to create such residual as now exists. In any event, the fact that there is some residual pain in the neck and shoulders, an a minor lack of feeling in a few fingers and the lower side of the forearm, is not sufficient to totally disable any man. There is no muscle malfunction or atrophy. The result is that the pre-existing condition materially intervened in and acted with the accident and, therefore, the policy does not cover the disability that resulted.

As to the event of February 21, 1964, careful analysis of the facts shows that placing the myelogram fluid in the back and removing it did not cause any sudden pain, or any disabilities in the Appellee. The usual temporary headache and perhaps ache in the lower back and legs, of a mild nature were noticed only. It is not this event, but the event when after the myelogram and when he had been directed to lie flat in bed, some few hours later Appellee stepped out of bed and upon standing up immediately felt severe pain from the hips to his feet. It is this severe pain which he claims has continued up to the present time, that is the major disability for which he seeks recovery.

The evidence is uncontradicted as to the following conclusions in relation to this February 21, 1964, event of stepping out of bed. The first is that no doctor had ever found or known of such a severe reaction to a myelogram occurring within a few hours of the myelogram. The second is that a reaction, if any, to the myelogram which would occur normally within 24 to 48 hours after it is practically always associated with a marked increase in temperature and commensured increase in

pulse rate and respiration rate, which is the normal result of a major inflamation of tissues of the body; but that in this case none of these indications were present. This conclusion is reinforced by the fact that the record kept by the hospital of the hour to hour treatment and care of the Appellee also indicates only mild medication and no unusual pains. The third uncontradicted conclusion is that for a myelogram to create irritation that could create a disability in the lower extremities would take time for the irritation to create scar tissue and for the scar tissue through adhesions or pressure to affect the nerves of the lower extremities. The pains having continued about as they commenced, and there being no neurological changes or muscle atrophy in the lower extremities of Appellee showing nerve damage, it is clear that irritation from the myelogram has not been proved.

Appellee has not proven that the disability in the lower extremities independently of all other causes came from the September 9 accident. There are two bases why this proof fails.

1. *Second Accident Caused Lower Extremity Pain.*

The most likely explanation of what happened is that a second accident happened to Appellee after the accident policy had expired. The event stepping out of bed on February 21 meets the definition of an accident, as the results of the event were unexpected, untoward and highly out of proportion of anything that occurred. It was uncontradicted that if the myelogram did cause it, the result was extremely unusual and severe.

The Idaho court has passed on similar situations and held a similar second event to be a separate and distinct

accident. In *Wilson v. New York Life Insurance Company*, 82 F.Supp. 292 (DC Idaho) Aff'd 178 Fed. 2d 534 (CCA 9th 1949) the insured had a hernia operation and when snoring under sedation thereafter violently coughed which broke loose a thrombus which caused death by a pulmonary embolism. While recovery was allowed because the infirmity was the accident, the court specifically says that recovery could not be had under such exclusion provisions where the bodily infirmity as here clearly existed prior to the accident or was contracted subsequent to and independent of the accident. 178 Fed.2d at 536.

The case holds that when in the medical treatment unusual, unexpected, and violent result compared to the cause occurs it is an accident, entirely separate from the pre-existing infirmity, the hernia, in the above case. The same logic is applicable here, the only distinction being the insurance policy was in effect at the time of the medical accident in the *Wilson* case but not at the time in our case. The Idaho court concluded that the unusual result of medical treatment was an accident and the proximate cause of the disability, and the same law applies here regardless of when the insurance policy was in effect. An example of this type of situation is *Aetna Life Insurance v. Brand*, 265 Fed. 6, cert. denied 40 S.Ct. 587, 253 U.S. 496, 64 L.Ed 1031, wherein the insured was operated upon for a hernia and during the operation, the surgeon punctured an artery located in an unusual place, gangrene setting in and the leg being amputated. The court stated

> "Considering this record, there is no evidence from which any jury could have found as a fact that

> Brand's hernia caused the pricking of his artery. Such a verdict would have been as far fetched as to find that, had the ceiling fallen while he was strapped to the operating table, the hernia that brought him to the table caused or contributed to the injury produced by the falling plaster." (265 Fed. at page 7.)

The court's holding of an accident within the policy despite the existence of preexisting condition based on the lack of casual relationship is equally applicable here. By the same logic it establishes that recovery could not be had from an unrelated earlier accident.

The Idaho court has followed the breaking of causation as to the second accident in a number of cases. In *Linder v. City of Payette*, 64 Idaho 656, 135 P.2d 440 (1943), a person who had suffered a former accident and had an eight-pound cast on his arm, fell out of a boat and drowned. This was held not to be in the normal consequence of the original broken arm and the chain of causation had been broken by a second accident which was intervening, independent and culminating cause, precluding the earlier accident from being the proximate cause. The same is true of the second accident in *Kiger v. The Idaho Corporation*, 85 Idaho 424, 380 P.2d 208 (1963).

While Appellant finds no case directly involving a myelogram, an analogy can be noted from a case where the administration of novocain in a tonsilectomy caused paralysis to the respiratory center and death. The unusual nature of the result was held to be accidental. *Mutual Life Insurance Co. v. Dodge* (CCA 4 1926), 11 F.2d 486, cert. den. 271 U.S. 677, 70 L.Ed.

1147. It is stated at 10 *Couch on Insurance*, Section 41:114, page 145 (1962) that

> "If for no foreseeable reason the insured dies from the administration of anesthetic, it is generally held that such death is an accident, is accidental or is caused by accidental means." (Cases cited).

While not strictly applicable, in that the broad test of foreseeability does not apply to contract cases, the negligence area cases indicate a similar result. A tortfeasor is liable only for the ordinary forms of professional negligence in treatment of the victim, but is not liable for unusual misconduct which is intentional injury, or extraordinary happenings. *Prosser on Torts*, Sec. 49 (2d ed. 1955), p. 272, 273; 2 *Restatement of Torts* 2d, Section 457, Comment d, p. 498 (1965). Leaving aside the question of foreseeability, there is no distinction in the application of the analogy of intervening cause or breaking of the chain of causation. In *Federal Life Insurance Company v. Raley*, 130 Texas 408, 109 S.W.2d 972 at 974, it has been held that where a plaintiff accidentally ruptured his right groin working for a railroad and the doctor operated on the left groin by mistake, the railroad was not liable as

> "such mistake was not an act of negilgence which could be found to flow legitimately as a natural and probable consequence of the original injury, and a ruling in effect to the contrary could not properly have been made."

> ". . . the act of the defendant in operating on the wrong side was a wholly wrongfully, independent and intervening cause for which the original wrong-

doer was in no way responsible." *Purchase v. Seelye*, 231 Mass. 434, 121 N.E. 413, 8 A.L.R. 503 (1918).

The analogy is equally applicable here where the result of stepping out of bed in no way has been related to the accident of September 9. He could just have well slipped on a banana peel and fallen at that point, as far as creating liability under the insurance policy.

Basically, the courts have realized that some limit must be placed on the insurer's liability, which otherwise could be stretched to infinity from one consequence succeeding after another in a chain of events beginning with an insured's accident. They have adopted, therefore, in the insurance cases the proximate cause portion of negligence law that the insurer is not liable for everything that happened that might not have happened but for the insured accident. If a person who caused the first automobile accident is held not liable for the aggravation to the neck and head injuries of the plaintiff in the first accident as a result of the second accident by a third person, *Armstrong v. Bergeron*, 104 N.H. 85, 178 A.2d 293 (1962), the fact of Appellee's original accident here shows the but for its existence the second matter would not have arose argument creates no liability.

The unusual and extraordinary and violent nature of the subsequent event is not includable within the original accident liability within the policy because proximate cause does not include "casualties which, though possible, were wholly improbable." *Corbett v. Clarke*, 187 Va. 222, 46 S.E.2d 327, at 328 (1948). In the present case, it becomes apparent that whatever the cause was, even if related to the myelogram, it was both highly unusual and unexpected.

2. *The Event Of February 21, 1964, Was Caused By Pre-existing Bodily Infirmities.*

Even if it can be argued the event which occurred when Appellee stepped out of bed was not a separate and distinct accident, the evidence clearly shows it was related to a bodily infirmity existing prior to the accident. The evidence is quite clear that it came from one or two other causes, both bodily infirmities. As noted, the 1947 accident to the Appellee's back was a major event. Appellee's witness, Dr. Shaw, and Appellant's witness, Dr. Raaf, both noted that one of the probable causes of the pain related to the earlier fusion operation.

If the physicians believed that it was due to some irritation of the nerve roots probably by scar formation, it is clear the scar formation referred to was from the earlier injury as it would not have had time to form within a few hours of the myelogram. (TR 195) The same conclusion as to the pre-existing infirmities is reached because Dr. Shaw testified that the number of prior accidents were a material part of his present disability. Dr. Raaf similarly testified, after stating without the pre-existing infirmities the neck symptoms would have subsided rather quickly, that the pre-existing osteoarthritis accounted for a part of his present disability. The same conclusion is reached by the statement of Dr. Burton and Dr. Shaw that each succeeding accident added its toll and that the last accident was the straw that broke the camel's back. Under the case law previously cited, this totaling of prior disabilities and the last accident is an excluded loss, even if a proximate relationship can be traced between the accident of September 9 and the need for the myelogram.

3. *Disability Not Due To Medical Treatment Within Accident Policy.*

While implicit in the earlier argument, a restatement of the proximate cause analogies is applicable to the question of medical treatment creating the loss after an accidental injury. Here there are two reasons which prevents any liability attaching from the original accident due to subsequent medical treatment, the first being that any loss resulting from stepping out of bed after the myelogram was so highly unusual and unexpected as to be an intervening cause, and the second is that the result of stepping out of bed can only be attributable to pre-existing bodily infirmities, and excluded cause. In effect, neither create a loss which results directly and independently from all other causes from the accident.

There is no evidence that establishes that several hours following a myelogram getting out of the bed is going to cause what happened here as a normal result of medical treatment, particularly when the event is so small and the result is so sudden and violent in relation to it. The same requirement of policy of directly and independently of all other causes, and the same exclusion clause, not from bodily infirmity, are applied to the medical treatment question. Thus, under an accidental liability policy which excluded items absorbed, inhaled or taken causing the loss, where death resulted from the cooperation of an unknown cause with chloroform administered by a doctor in relation to treatment of an accident injury, recovery was not allowed. *Westmoreland v. Preferred Accident Insurance*, 75 Fed. 244 (Cir. Ct., N.D. of Ga.).

While the rule in case of negligence is that the tort-

feasor takes the injured person in whatever condition he may have been found, this does not apply to accidental insurance cases. Only the proximate cause relationship is applicable from Tort law, and the cases cited above followed the theory that the mere fact an automobile accident happened, and a meteorite happened to strike the person after his car was wrecked, does not mean the injury from the meteorite could be recovered for in an insurance case. This can be stated also that the second incident, stepping out of bed, by itself is a sufficient sole and proximate cause of a disability and if that is true to relate back the first accident of September 9, 1963 could not also be one. That the unusual second event occurred while Appellee was in the hospital but not directly caused by or related to the September accident, does not change this reasoning.

In summary, the facts in this case show the actual disability from which Appellee claims to be totally disabled is that of the lower extremeties, not the cervical spine, and he has failed to prove that this lower extremities disability was not a separate accident, was not based on pre-existing bodily infirmities, was not the normal and usual result of medical treatment, and to the contrary the evidence shows that whatever occurred must have acted in conjunction with the existing disabilities. The Idaho court has held in *New York Life Insurance Co. v. Wilson, supra*, that in combining the directly and independently of all other causes clause with the exclusionary clauses for illness or bodily infirmity, that the exclusionary clauses nevertheless would allow recovery where there is

> " . . . bodily infirmity or disease directly attributed to and approximately caused by the accident. Such

> provisions apply only to bodily infirmity or disease existing prior to the accident or contracted subsequent to and independently of the accident." 178 F.2d 536.

The case thus held the thrombus was a bodily infirmity which would normally avoid recovery under the accidental policy, except for the fact that it was the accident in itself. In the present case, if the pain and cramps in the lower leg on the stepping out of bed were the accidents in themselves, they did not occur in the policy. Secondly, it is uncontradicted that the event of stepping out of bed was in conjunction with or aggravated pre-existing infirmities.

For example, an accident fractured the insured's leg at a point where a cyst had developed as a result of a disease, and the disease interfered with the healing of the leg after the injury, whereby recovery under the accident policy was denied based on the combination of an accident and pre-existing condition. *Davis v. North American Accident Insurance Company*, 42 Wash. 2d. 291, 254 P.2d 722. See also *Romanoff v. Commercial T. M. Accident Association*, 243 App. Div. 725, 277 NYS 291. By comparison after an accidental fall, an operation on a previous existing hernia was required. Due to the operation and the subsequent weakness, the insured contacted pneumonia and died. The physicians testified pneumonia germs were present in well persons and that a weakened person was more susceptible. The court allowed recovery, saying

> "We hold, therefore, that when death results from disease *which follows as a natural* though not necessary *consequence of an accidental injury*, it is within the terms of the accident certificate, death being

deemed the proximate result, not of the disease as independent cause, but of the injury." *Kane v. Order of United Commercial Travelers of America*, 3 Wash. 2d. 355, 100 P.2d 1036 (1940) at 1040. (Emphasis added.)

These analogies show the crucial distinction, as to whether the chain of causation is continued in the first place, and second, even if it has, whether bodily infirmities which occur in conjunction with the accident are within the exclusions of the policy. If either the chain of causation is broken or an excluded cause cooperates with the original cause, no recovery is allowed. The Appellee in this case is no more entitled to recovery than the insured who accidentally stubbed his toe on some furniture and delayed going to the doctor for a few days, at which time it was discovered his middle toe was broken. Subsequently, he entered the hospital for a desired amputation of said toe and in a routine examination was found to have diabetes, which lead to a postponement of the operation for some four weeks as it would be hazardous. Later on entering the hospital for the amputation, it was discovered that the toe had gangrene and required amputation of the leg at the knee, from which the insured died. The autopsy revealed the insured suffered arterio-sclerosis, an affliction of the heart, enlarged kidneys, and a disease pancreas. Instruction to the jury that recovery could be had regardless of concurring causes, one being the injury and the other being the diabetes, was held error. *Maryland Casualty Company v. Morrow*, 213 Fed. 599 (CCA 3rd 1914).

D. APPELLEE HAS NOT SHOWN TOTAL DISABILITY OR PROPER PROOF OF LOSS

Assuming for purposes of argument, without con-

ceding the same, that the disability of the Appellee arose within the coverage of the policy, he has failed to prove total disability within the proof of loss provisions. After the accident of September 9, 1963, total disability could only exist "after one year of continuous total disability." The facts show that he had his accident a little before noon on September 9 and continued on the job until sometime after lunch, going to the first aid station. His first day off work was September 10. "After one years of continuous total disability" would not occur until at least September 10, 1964. There was no evidence of the receipt of Exhibit 2, consisting of the proof of loss form and the attending physician statement, except its date September 8. The pretrial order, R48-9, was amended on motion of Appellant, R51-54, which is allowed as to paragraph 3 thereof at TR3-4, provides that Exhibit 2 was received by Appellant on or about September 9, 1964. On this record, the court by Instruction No. 11, (TR 434) said

> "You are further instructed that legal notice and proof of loss were timely made."

Error was thus committed by withdrawing a factual issue from the jury, particularly where only an inference could be drawn from the pretrial stipulation as to receipt, but no evidence existed as to whether or not notice was made after one year continuous total disability.

That the sufficiency and receipt of notice and proof of loss are for the jury is undisputed if any issues of fact exist. The issue here is not whether proof of loss was received by the company, but whether the condition precedent after which it could be filed had occurred.

"The giving of notice provided for in an insurance policy is generally spoken of as a conditioned precedent to the insurance duty to pay . . . the burden of proof is upon the plaintiff to plead and prove compliance or excuse for noncompliance with such condition." *Kennedy v. Underwriters at Lloyds, London,* 32 Cal. Rptr. 685 at 687, 219 Cal. App. 2d 11 (1963).

Because the pleading of the Appellant denies the allegations of plaintiff's complaint alleging due notice, R34, the mere stipulation that proof of loss was received at an approximate time is not a stipulation of fact that it was received after the required waiting period in the policy. Only if all these matters has been affirmatively stipulated would there be no burden of proof for Appellee to meet and would the instruction have been proper. *Reserve Life Insurance v. Luedke,* 132 Ind. App. 476, 177 N.E. 2d 482 (1961).

The substantial compliance rule does not aid Appellee in this matter. It is not a question of the company receiving the notice, to enable it to make due investigation, but a question of whether a conditioned precedent for an expiration of time as required in the policy had been met. There is insufficient proof upon which the court could decide as a matter of law in Instruction No. 11 that the policy terms had been complied with. Even if it can be argued that inference may have arisen from the pretrial order, this still leaves a question of conflicting inferences. Was it before the 9th of September or sometime a number of days after the 9th of September? In such event it is nevertheless, a question for the jury on conflicting inferences. *Long v. Equitable Life Assurance Society of the United States,* 70 Ohio App. 277, 60 N.E.2d 805 (1945).

The Idaho court in *Bennett v. New York Life Insurance Company*, 63 Idaho 427, 121 P.2d 551 at 555 quoted from *Conlon v. Northern Life Insurance Company*, 108 Mont. 473, 92 P.2d 284, approving the general principle that, proof of loss being the conditioned precedent as well as notice of loss being a conditioned precedent, the burden is on the Appellee plaintiff to show compliance with all of these requirements, and in failing to do so, the court must direct a verdict for the insurer. Specifically, the uniform provisions of the policy, R 44, require that notice of claim be given within twenty days after the occurrence or commencement of any loss or as soon thereafter as reasonably possible. In a separate paragraph written proof of loss must be furnished within 90 days after the date of a loss. Thus it is noted that Appellee should have given notice of possible claim after his injury, but before the total continuous disability for one year had existed, to allow the insurer to investigate the matter. There is absolutely no proof that any notice of claim was given. Under the above-cited *Bennett* case, the Idaho court has followed the principle that both notice of claim and proof of loss must be shown as a conditioned precedent.

The key point is that the Appellee could not have known until after the full year of continuous total disability whether or not he would be permanently and totally disabled. In fact, as Appellee relies on the pain and lack of sensitivity in his left arm as part of his disability, and the record clearly shows that these did not arise until sometime after the original accident. The loss involved is not the accident, or the beginning of it, but in total disability cases is the completion of a period of time, which would be late in September.

As to the proof of total disability, assuming proper

proof of loss had been made. Even assuming for the purpose of argument an accumulation of the disability from accidents and disabilities arising therefrom, it is clear Appellee has failed to prove by a preponderance of the evidence total disability. Nevertheless, such existing disability cannot include loss resulting from or caused by illness and bodily infirmity. The plaintiff's proof would have to separate out and distinguish that portion of all of his disability which could only arise from the accident of September 9, 1963, and prove that this totally disabled the Appellee. He therefore has not proven total disability within the policy terms.

The evidence is uncontradicted that the Appellee can engage in some work. His testimony shows that he is a literate person, that he can read and write, that he has had extensive travel and work in foreign lands with the experience commensurate therewith, and that he is familiar with the organization of construction jobs and the equipment used thereon. The fact that the Appellee has deliberately not applied for any other job of any type since May of 1964, clearly shows the failure of Appellee's proof that he could not work. The mere fact he couldn't sweep the floor three months after his cervical spine operation is not proof that at the time of the suit he could not engage in some work.

Appellee has another problem. The surgery in February 28, 1964, materially corrected the disability from the September accident. It is only because of February event that he has any difficulty in his lower legs which is his main complaint and reason for being unable to work. It cannot possibly be claimed that the latter ground has existed for a continuous year prior to proof of loss. The term "permanent disability" is defined as:

> "The common interpretation of the expression 'permanent' is . . . a disability which will persist for a long or indefinite period of time, as distinguished from a condition which is merely transient or temporary." 1A Appleman, *Insurance Law and Practice*, p. 529; *Crowe v. Equitable Life Assurance Society of the United States*, 179 La. 444 154 So. 52, (1934).

A new disability arose in February, yet the proof of loss claims only disabilities from the September 9 accident. The total year has not expired, as to this new matter.

That a proof of loss may come too early and avoid the action has been so held. In *Hovhanesian v. New York Life Insurance Co.*, 310 Mass. 626, 39 N.E.2d 423, 138 A.L.R. 1369 (1942), the proof of disability was ruled insufficient, one of the main grounds being that it was received 12 days early prior to the completion of a 60-day period of disability. See also *Columbian National Life Insurance Company v. Buntin*, 43 Ga. App. 698, 159 S.E. 891 (1931). *Corbett v. Phoenix Mutual Life Insurance Co.*, 259 N.Y.S. 221, 144 Misc. 872 (1932).

It therefore appears that Appellee has failed to meet his burden of proof in relation to the proof of loss provisions of the policy and the total disability provision therein.

E. THE COURT BELOW COMMITTED SUBSTANTIAL, PREJUDICIAL ERRORS AT TRIAL

Listed hereafter are matters which Appellant believes are substantial, prejudicial errors committed during the trial of this action.

1. Admission And Rejection of Evidence

The court committed substantial error in admitting Exhibit 20, marked TR 243, admitted 246. The exhibit is a report of medical examination made of the Appellee by a Dr. H. V. Firor, dated September 17, 1962. The exhibit was offered as a part of a direct examination of Alfred J. Goade, manager of accounting and administration for Morrison-Knudsen Company (TR 239). It was objected that it was hearsay, (TR 244, line 25) and upon further questions in aid of the objection further objected to as not binding upon the insurance company, as immaterial and irrelevant, incomplete and without proper foundation as a business record maintained under the supervision of the witness. (TR 245) The physical examination had nothing to do with the issuance of the insurance policy, was a record maintained by the personnel office and not under the control and maintenance of the witness in accounting. (TR 244) The witness did not know if there were any other laboratory reports, x-rays or other sheets with the report because "I asked for this and this is what I received." (TR 246) It was error to admit this exhibit, as the court practically conceded in its remarks before the jury, stating: "My only question now is whether you want to take time to get the office manager to identify them." (TR 246) The admission was particularly damaging because it did not list the previous disabilities, and because on the face of it it states: "Physically qualified for arduous work overseas."

The business records exception to the hearsay rule does not permit the admission of this evidence. § 9-413 to 9-416, Idaho Code and § 28 U.S.C.A. 1732 have both been interpreted under the general rule to only allow

admission of records made in the regular course of business, if they are properly identified and if they are offered by the custodian or other qualified witness who prepared them or supervised their preparation. The same rule applies to medical records, as it is stated:

> "Medical records, in order to be admissible in evidence, must be properly identified and authenticated by the custodian or other qualified witness, and there must be proof of compliance with requirements of the statute relating to the admissibility of business records." 32 C.J.S. §730(2), at p. 1054.

> "A writing is not admissible under a business record statute merely because it may appear on its face to be a writing made by a physician in the regular course of his practice, but it must first be shown that the writing was actually made by or under the direction of the physician at or near the time of his examination of the patient in question and also that it was his custom in the regular course of his professional practice to make such a record." Supra at p. 1053.

It has been held that where papers were not the product of a regular clerical system, had not been checked and supervised in their preparation by a supervisor of any nature in relation to the person seeking to authenticate the document, and involved independent discretion and judgment of a person preparing them, that they are not admissible. *Hartzog v. United States*, 217 F.2d 706 at 710. Berlin, a special agent of the Internal Revenue Service, testified as the alleged supervisor of the making of certain work sheets by a deputy collector named Baynard. The work sheets of said Baynard, who had died, were somewhat haphaz-

ard in their preparation, and as to their admissibility under identification by the special agent Berlin, the court stated:

> "On the record presented to us, it does not appear that the work sheets prepared by Baynard were prepared under such circumstances as will provide a guarantee of trustworthiness. . . . They were Baynard's personal working papers, were the product of his judgment and discretion and not a product of any efficient clerical system. . . .
>
> "The second circuit quite properly held that testimony of a supervisory agent alone is sufficient when he has had complete supervision and direction of the preparation of the evidence which he offers. We do not think such supervision and control existed in the instant case. Baynard was not a mere tool of Berlin. He exercised his own discretion and judgment as to the classification of the information which he alone saw. While Berlin may have been his 'supervisor,' in fact the two parties were operating on the same level of this investigation. Moreover the Mortimer case is founded on the assumption that the evidence was compiled 'according to a method at once practical and offering reasonable guaranty of accuracy . . .' 18 F.2d at p. 269. We do not think that Baynard's work sheets were prepared by such a method." 217 F.2d at 710.

In the present case, the witness as the manager of the accounting department was not the supervisor over the personnel department from which the record was obtained, and he merely got it by asking for it. There is no evidence of supervision of the doctor, or how his report was required or made. There is an absolute

failure of proof as to the source of the record in the personnel department, or whether the procedure under which the company obtained it was the result of "any efficient clerical system." It is clear that even if it was identified that there was no foundation for the other requirements of the business record exception to the hearsay rule. Proper objection was made.

A second substantial prejudical error was committed by the court below in refusing to allow Appellant to read to the jury and ask questions concerning prior inconsistent statements of Appellee. The verified complaint was marked as Exhibit 12, and the appellee asked to read

> "On or about September 9, 1963, the plaintiff suffered an accidental injury to his spine causing immediate total disability." R11

This was not read to the jury and when the Appellee was asked if he still claimed that his disability arose immediately following the accident of September 9, 1963, the court sustained an objection which contained no reason for it (TR 86, line 3) and refused to admit the exhibit when it was offered even though no objection was made by Appellee to the offer. (TR 86, lines 15-25) This has been held to be error:

> "Admissions, if material, are always admissible. Sometimes they have a controlling weight with a trier of facts. There can be no more solemn admissions than those made by a pleading, the very purpose of which is so to state the pleader's claims that they may be submitted to a judicial tribunal for final determination. For that purpose, they are drafted, submitted, and become part of the record.

Although a part of the record, his own pleadings cannot be used by a party over objection because they are his own statements, prepared for the very purpose of putting his case in the best possible light. Hence, they are ordinarily selfserving and so should not go before the jury at all. But when a party incorporates in a pleading an admission, an opposite condition is created and the confession may be used by his adversary at any time during the trial and for any legitimate purpose, without introduction in evidence . . . The only thing to be determined by the judge as a preliminary is whether the pleading is an admission or reasonably to be construed as such. If that be the case, it may be read to the jury at any proper time on behalf of the adversary." *Hork v. Minneapolis Street Railway Co.*, 193 Minn. 366, 258 N.W. 576 (1935) at 577.

Further, courts allow pleadings to go into evidence to show admissions against the party who has pleaded them. Thus it is stated:

"That allegation may be regarded either as a formal admission for the purpose of this action, and as such binding and conclusive throughout the case upon those in whose behalf it was made; or as an evidentiary declaration. And, even considered in the latter and less absolute fashion, it is highly significant. It is to be understood as the reflection by plaintiffs' counsel of the factual setting of the misadventure in suit, which had been disclosed to their counsel by or in behalf of the plaintiffs. It is a purposeful assertion by plaintiffs of an ingredient of the claims in substantial sums which in this action they made against the defendant. They are not thought to have made the assertion lightly or without supporting his-

torical background." *DeLegrand v. United States* 182 F. Supp. 184 at 195. (Dist. Ct., Puerto Rico, 1959 or 1960.)

The court erred even more seriously and substantially in refusing to admit Exhibit 10. It was stipulated that said exhibit was authentic, with reservation of materiality and relevance. (TR 84, R 62) Identification being waived, Appellant offered ¶ 7 thereof and the court interrupted Appellee's counsel to state his own objection to it, asked the Appellee's counsel for an objection and sustained it. The provision which was excluded reads as follows:

> "That prior to September 9, 1963, the claimant sustained compensable industrial accidents to his lumbar spine, cervical spine, hands and face. That the combination of said previous injuries and the injury of September 9, 1963, have resulted in permanent disability and physical impairment equal to 100 per cent total permanent disability." (Paragraph 7 of Amended Complaint Before the Idaho Industrial Accident Board)

The Appellee testified that he had hired counsel to file the industrial accident claim for his 1963 September accident, that he hired Mr. Roberts and his associates, who are his counsel in this case. This was a substantial contradictory admission against interest and it is particularly interesting to note that it is an amendment to the actual original claim that was filed. The law is clear that such a statement against interest was admissible.

> "Under the rules discussed in subdivision a of this section the pleadings in a suit or action are admis-

sible for some purposes, as in the case of a verified pleading in a former action involving one or more of the parties to the suit, provided the pleadings are relevant and material . . . In a proper case a pleading may be introduced to collaborate or contradict a witness, to rebut an inference, or to establish an admission against interest . . ." 32 C.J.S. Evidence §633b, p. 804.

"Pleadings in one action are competent evidence in another, where the purpose is to contradict a party or his witness . . ." *Regenvetter v. Ball*, 131 Wash. 155, 229 Pac. 321 at 324 (1924).

The cases cited above in relation to Exhibit 12 are also applicable here. As the witness was not allowed to testify as to these matters or the jury to be informed on them, two very strong contradictory statements which were material and relevant were excluded.

A fourth item is the rejection of an offer of proof and sustaining objections to questions by Appellant concerning the amount of pay Appellee received in the last few years. Appellee was asked what he was paid at the Iran job and an objection was made that this was not material or relevant, which was sustained. (TR 389-90.) A request to make an offer of proof was made and subsequently granted. The offer of proof appears at TR 396, which are quotations from a deposition of Appellee. They show that in Iran he was making $1,000.00 a month, plus subsistence and in Colombia he was making $900.00 a month without subsistence. At the time of the original question, Appellant pointed out that this was relevant as to the ability of the Appellee in relation to his disability. The court rejected the offer of proof. This was error in that the amount

of money he received on his most responsible recent jobs indicates that he was acting as a supervisor and had the capacity to do supervisory work. As there is definite evidence that he can go back to a job so long as it doesn't involve heavy physical labor, this evidence was material and relevant in the question of whether he is totally and permanently disabled from carrying on any occupation or employment for which he is fit through education, training or experience.

2. Errors In Instructions To The Jury

The detailed instructions to which objection has been made are set forth in the specification of errors. The essence of the problem, except for definition questions, is the holding of the court as a matter of law that the "directly and independently of all other causes" clause of the policy includes the exclusionary provisions and that no instruction need be given on the exclusionary clauses of the policy. This is made clear in the court's comments to the Appellant's request that the exclusionary matter be added to Instruction No. 13. The court denied the request stating: "I feel 'directly and independently' must be all inclusive." (TR 424)

As to the individual errors believed committed by the court, they are as follows:

(a) The combination of Instructions Nos. 11 and 13 omit an essential element. We have already pointed out the error of instructing that "legal notice and proof of loss were timely made" (Instruction 11, TR 434) in that there was a question of fact for the jury. The question was whether the full year of "continuous total disability" had run at the time the proof of loss was filed. While Instruction 13 in ¶ 2 requires that the Ap-

pellee prove that such a full year of inability existed, at no point did either instruction raise the question for the jury of whether Appellee's proof of loss was filed only after such period had expired. The Court commits substantial error because in Instruction 13 it requires the jury to find whether such full year has existed, and yet by Instruction 11, by deciding as a matter of law that the proof of loss was timely, it decided the question of fact which it had submitted to the jury. There is no stipulation and no evidence that would create an uncontradicted evidentiary situation as to whether or not a full year of continuous total disability had existed before filing and the issue had to go to the jury. For this reason the instructions are inadequate. This was called to the court's attention in the second half of Appellant's requested instruction No. 2 (R 155) (TR 420-421).

(b) The next error relates to ¶ 2, line 8, of Instruction 10, the statement that the insurance company contends that the disability of February 21 resulted from the diagnostic treatment. Appellant requested that this should be deleted as the issue was not the treatment but the unusual result from stepping out of bed. (TR 434) The change was not made. Objection was also made in ¶ 2 of Instruction 10 to the words at line 9, (TR 434) "such event constituted an accident," that it was not clear which event was noted, and that the wording should read "such event constituted another accident." (TR 423) The instruction as written is confusing as to the specific claim of the Appellant that the February incident of stepping out of bed was an additional accident.

(c) Instruction 13 in ¶ 3 (TR 436) is the major

error in the court's instruction. Appellant specifically requested that the facts which must be found by the jury as to hold for Appellee should include both the clause of "directly and independently of all other causes," and an instruction concerning the exclusion if the same was effected by disease or bodily infirmity. As cited above from TR 424, the court specifically denied this, stating the "directly and independently" clause was all-inclusive. Also denied was Appellant's request that there be added to Instruction 13 the additional question of proof of whether the disabilities were caused by another accident following the September 9 accident (TR 424). The Appellant's requested instruction No. 4 in the latter part of the first paragraph requested this provision. Denying it is error, for this is a material question of fact.

(d) In Instruction 15, the court committed an error in adopting Appellant's requested Instruction 5 while deleting the last clause (R 158, TR 425). This is a defiinition of an accident and the deleted portion added "and is tragically out of proportion to the trivial cause." (TR 425) As the definition of an accident is both one that is improbable as well as a result out of proportion to the cause, the instruction as given is erroneous.

(e) Objection was made to Instruction 16 on the same basic reason as to Instruction 13, in that it includes the question of a cause being directly and independently of other causes without relation to the exclusion clauses of the policy (TR 425). The same argument applies.

(f) Objection was made to Instruction No. 17 re-

lating to Appellee's duty to submit to reasonable medical treatment in that it is inadequate to cover the pertinent question of whether the results of said treatment are within the accident policy. It being a question of fact whether the results of the event in February were so unusual and unexpected as to be a separate accident, or as to be an unexpected result of medical treatment, the jury is improperly instructed on this question (TR 425). Appellant requested an instruction in the first part of Requested Instruction 8 and in its oral request to the effect that ". . . if the normal treatment resulted in bizarre or unusual results, that we would not be responsible for them." (TR 425) Failure to instruct was error as material questions of fact existed as to the medical treatment, if that is what caused the disabilities upon stepping out of bed, and it should have been given to the jury.

(g) The same objection is made to Instruction 13, for the same reason (TR 425).

3. Prejudicial Remarks Of The Court

The impartial attitude of a judge on the trial of an action is most important. It has been so held in an action by plaintiff seeking to prove permanent total disability under an insurance contract, where the court commented about the insurer government's alleged practice of concealing information in its files,

> "Nor is this the only instance in the record where the judge failed to maintain an impartial attitude. He displayed a very hostile attitude to the defendant's witness, Dr. Wilson, and constantly prompted witnesses for the plaintiff. In these insurance cases brought by soldiers, every sympathy of

the juror is with the plaintiff and it is particularly imperative that the trial judge observe a scrupulous detachment." *Mason v. United States*, 63 F.2d 791 (C.C.A. Vt. 1933).

This case is in point with reference to the remarks of the court below concerning the admission of the physical examination, Exhibit 20, where the jury would be clearly convinced that the record was of some unusual importance, that the Appellant's objections to its admission were an effort to hide evidence that was material, and that the Appellant was merely delaying the trial (TR 243-246). On Appellee's objection, the Court first asked whether the Appellant wanted a recess, when it was the Appellee who was trying to offer the exhibit. He blamed the need for the recess, which was not called, on the Appellant because he would have to call the "proper officer." He then stated, "I don't believe it would be necessary," as to whether the proper officer should be called, and proceeded to examine the witness of the Appellee for the purpose of trying to lay a foundation for admission of the exhibit on behalf of the Appellee. The Appellant's attorney then found himself in the position of having to ask questions in aid of objection to the questions that the court was asking. (TR 245) At this point for the third time the court stated:

> "My only question now is whether you want to take time to get the office manager to identify them." (TR 246)

This required Appellant's counsel again to state the objection, for the third time, that no proper foundation or identification had been made, to which the court then replied:

> "I am satisfied the identification is satisfactory and I am going to overrule the objection and I am going to admit Exhibit 20 . . ." (TR 246)

While the record does not reflect the inflections of the trial court, it is not difficult to understand in reading this last statement by the court below that it was made with some emphasis.

The errors committed by the court here are multiple, and they are in conjunction with a number of other remarks which indicated to the jury through accumulation, if not by individual nature thereof, the court's attitude. The court actively participated on behalf of Appellee following the offer of the exhibit by the Appellee noted above and at no point in the course of four pages of transcript did Appellee's attorney ever have to argue his side of the issue on the admission of the exhibit—the court was doing it for him.

The authorities specifically admonish a trial judge from so entering into a case.

> "It is well known that jurors observe the suggestions and bearing of the judge during the trial, and if they can catch an expression or suggestion of the opinion of the court as to his views of the merits of the case, they are almost sure to reflect that opinion in their verdict. It is clearly reversible error for the court to make such a remark during the trial in the presence of the jury." *Goldstone v. Rustemeyer*, 21 Idaho 703, 123 Pac. 635 (1912), See also *LaChase v. Sanders*, 142 Conn. 122, 111 A.2d 690 at 692 (1955), and *Forte v. Schiebe*, 145 Cal. App. 2d 296, 302 P.2d 336 at 338 (1956).

In the *Goldstone* case the Idaho court commented, as to the value of merchandise delivered by an appellant to a respondent, that a specific witness "has told them what it would be worth." This is quite similar to the court's remark here as to what the record of medical examination showed (TR 245) and that the exhibit was proper except merely as to the presence of an office manager to identify it (TR 245).

> "The practice of a judge entering into a trial of a case as an advocate is emphatically disapproved. The judge occupies an exalted and dignified position; he is the one person to whom the jury, with rare exception, looks for guidance, and from whom the litigants expect absolute impartiality. An expression indicative of favor or condemnation is quickly reflected in the jury box and at the counsel table. To depart from the clear line of duty through questions, expressions, or conduct, contravenes the orderly administration of justice . . ." *LaChase v. Sanders, supra.*

The court actively did all the things condemned in the above citation, including questioning the witness, arguing the Appellee's position for admission of the exhibit, remarking on its contents, and attempting to browbeat Appellant's counsel out of his objection by pointing to the delay that it was going to cause in the trial.

This same attitude of the court was reflected when Appellant was cross-examining Appellee's witness, Dr. Shaw (TR 192-193). In a chain of questions asked on the ability of Appellee to work, the court interrupted Appellant and (a) as to a question that was two answers back, (b) sustained an objection which he didn't even allow Appellee's counsel to state, and (c)

accused Appellant of asking an unfair question. He further erred in striking an answer of Appellee to appellant's question. Without reference to what question he was talking about, the court stated:

> "I don't think this is a fair question based on the testimony. I think it was his testimony he wasn't a working supervisor over these 150 men."

In a robbery case where the witness was testifying as to whether the plaintiff had checked into the hotel before or after the robbery and thought it was before, the trial court interrupted with the statement, "It doesn't make any difference, objection sustained." There the court stated:

> "The prejudicial conduct of the judge was made glaringly manifest, because he said 'objection sustained' when no objection had been interposed. Other remarks of the court were upon a similar line. These remarks of the trial judge were uncalled for, highly detrimental to the rights of the defendant, and were calculated to impress the jury that the judge was exerting himself in the interest of the plaintiff." *Coulson v. Wenzel Hotels, Inc.*, 248 Ill. App. 540, at 544 (1st Dist. App. Ct. 1928).

This is almost identical here, where the court below interrupted, sustained his own objection before the Appellee could even make one and struck the answer without a motion. This also happened elsewhere in the trial, to wit: The court interrupted Appellee on direct examination to say: "Would you like a glass of water?" (TR 30); interrupted Appellant's cross- examination of Appellee purportedly to keep out in advance otherwise inadmissible evidence without objection of Ap-

pellee's counsel (TR 50); interrupted Appellant's cross examination as to previous inconsistent statements by cutting off the Appellee's answer and commencing to ask Appellee questions himself (TR 50); by remarking that the vocabulary of the Appellee was a little bit more limited than counsel's (TR 51); cut off an objection to an offered exhibit being made by Appellee, stating the grounds for an objection he believed proper, with the request that the Appellee make such objections, which he then sustained (TR 84); sustained an objection that did not state any grounds to the admission of an exhibit of Appellant's and set forth the grounds in the statement sustaining the objection (TR 86); suggested to Appellee's counsel how to reword an objectionable question without ruling on the objection to it (TR 117-118); and suggested to Appellee's counsel on Appellant's objection that he change the word "allergy" to "irritation" in a question as to the myelogram's effect (TR 405).

Another example is where without Appellee's objection, the court prevents Appellee from testifying on Exhibits 8, 9, and 10 (TR 81).

Each of these particulars were in aid of the Appellee's case, and there is not a single instance where the same thing was done for the Appellant's case. This was held reversible error in the case of *Hays v. Viscome*, 122 Cal. App. 2d 135, 264 P.2d 173, at 179 (1953); there plaintiff contended that she was prejudiced by the conduct of the trial judge, consisting of constant interruptions of her counsel and her witnesses, comments of a critical nature and innumerable rulings sustaining objections upon trivial grounds, all of which, it was claimed, indicated the court was out

of sympathy with her case. The court declared:

> ". . . Although there is no evidence of prejudice in a legal sense, there is abundant evidence of a failure to exercise the high degree of patience and forbearance with counsel and witnesses which is the constant duty of the court in the trial of a jury case. It has been emphasized, time and again, that jurors are quick to observe the attitude of the court toward litigants and their counsel, whether favorable or unfavorable, and to be influenced thereby . . . When complaint is made upon this score, we have no disposition to be critical of the conduct of the trial court, and yet we may not ignore or minimize assignments of misconduct made with conviction and in good faith."
>
> "Although one of several incidents of errors, standing alone, may be disregarded as harmless error, it is still possible that when considered in total they accumulate with such a cumulative prejudice that they may require reversal." Am. Jur. 2d, Appeal and Error §789, p. 230. See also cases cited there.

It is submitted that the above actions clearly intimated to the jury the court's attitude was favorable to Appellee to the prejudice of the Appellant.

APPENDIX

TABLE OF EXHIBITS

No. & Description of Exhibits	Marked	Admitted
	(Record Page)	
Plf. Ex. 1—Application for Insurance	48	48
Plf. Ex. 2—Proof of Loss and Attending Physician's Statement	48, 49	48, 49
Plf. Ex. 3—Copy of the Insurance Policy	48, 49	48, 49
	(Transcript Page)	
Def. Ex. 4—Accident Policy	19	20
Def. Ex. 5—Employee's Application	19	20
Plf. Ex. 6—Hospital Records	79	111
Plf. Ex. 7—Hospital Records	79	(Not offered)
Def. Ex. 8—Memo of Agreement & Summary	80	(rejected, 83)
Def. Ex. 9—Industrial Accident Board File	80	(rejected, 83)

Def. Ex. 10—Industrial Accident Board Records	80	(rejected, 85; R180)
Def. Ex. 11—Reports of Nevada Industrial Commission	81	(rejected, 83)
Def. Ex. 12—Complaint	81	(rejected, 86)
Plf. Ex. 13—Anatomical Drawing	113	114
Plf. Ex. 14—Post card	164 (R173)	164 (R173)
Plf. Ex. 15 & 16—X-rays	197 (R173)	198 (R173)
Plf. Ex. 17 & 18—X-rays	198 (R173)	199 (R173)
Plf. Ex. 19—Application card for Insurance	240 (R173)	246 (R173)
Plf. Ex. 20—Physical record of Morrison-Knudsen	243 (R173)	246 (R173)
Plf. Ex. 22 through 28—X-rays	401 (R176)	401 (R176)
Def. Ex. 29—Letter dated September 9, 1964	413 (R176)	(Not offered, R176)

CERTIFICATION

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules (with special application made for permission to file additional pages in the brief).

T. H. Eberle
....
Attorney
RICHARDS, HAGA & EBERLE
Boise, Idaho

No. 20822

IN THE

United States Court of Appeals
For the Ninth Circuit

INSURANCE COMPANY OF NORTH AMERICA, a corporation

Appellant,

vs.

THOMAS J. THOMPSON,

Appellee.

BRIEF OF APPELLEE

Appeal from the United States District Court for the District of Idaho

ROBERTS & POOLE
111 Broadway
Boise, Idaho
Attorney for Appellee

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111 Broadway
Boise, Idaho
Attorney for Appellee

SUBJECT INDEX

PAGE

TABLE OF CASES i
TABLE OF STATUTES iii
TEXTS CITED iii
I. JURISDICTION 1
II. STATEMENT OF FACTS 2
III. ARGUMENT 7
1. Summary 7
2. Specific Issues 8
(a) Response to Specification of Errors Nos. 1, 2, 3, 11, 12, 16, 22-28 8
(b) Response to Specification of Errors Nos. 4 and 5 9
(c) Response to Specification of Errors Nos. 6 and 8 11
(d) Response to Specification of Error No. 7 20
(e) Response to Specification of Errors Nos. 9 and 10 20
(f) Response to Specification of Errors Nos. 13, 14, 15, and 17 22
(g) Response to Specification of Errors Nos. 18 and 20 26
(h) Response to Specification of Error No. 19 27
(i) Response to Specification of Error No. 21 29
(j) Response to Miscellaneous Issues 37
3. Conclusion 41
CERTIFICATION 42

TABLE OF CASES

PAGE

Ballam v. Metropolitan Life Insurance Co. 3 N.E. 2d, 1012 24
Cody v. John Hancock Mutual Life Insurance Co. 163 S.E. 4 23

Collins v. Casualty Company of America 24
112 N.E. 634
Coulson v. Wenzel Hotels, Inc. 35
(First Dist. App. Ct.), 248 Ill. App. 540
Culver v. Prudential Insurance Co. of America 23
179 A. 400
Davis v. Jefferson Standard Life Insurance Co. 16
73 F.2d 330
Gardner v. United Surety Co. 24
125 N.W. 624
Goldstone v. Rustemeyer 35
21 Idaho 703, 123 Pac. 635
Hays v. Viscome 35
122 Cal. App. 2d 135, 264 P.2d 173
Hope Spoke Co. v. Md Casualty Co. 11
143 S.W. 85
John Hancock Mutual Life Insurance Co. of 15
Boston, Mass., v. Crock, 216 F. 2d 805
(C.C.A. 4th)
Kent v. Campbell 8
80 Idaho 28, 324 P.2d 388
La Barge v. United Insurance Co. 15, 19
306 P.2d 380
La Chase v. Sanders 3
142 Conn. 122, 111 A.2d 690
Lado v. First National Life Insurance Co. 1
162 So. 579
Landon v. United States 2
197 F.2d 128
Mah See v. North American Acc. Ins. Co. 2
(Calif) 213 Pac. 42
Mason v. United States 3
(C.C.A. Vt.), 63 F.2d 791
Metzenbaum v. Metzenbaum 3
(Calif), 214 P.2d 603
Mober v. Continental Casualty Co. 2
37 Idaho 667

Moore v. Southern Life & Health Co. 14
195 So. 857
Mutual Life Insurance of N.Y. v. Knight 23
178 So. 898
New York Life Insurance Co. v. Jennings 22
6 S.E. 2d, 431
New York Life Insurance Co. v. McGehee 18
(1958 CA 5 Ala) 200 F.2d 768
New York Life Insurance Co. v. Wilson 17, 19, 38
178 F.2d 534
O'Neil v. New York Life Insurance Co. 21, 22, 37
65 Idaho 722, 152 P.2d 707
Rauert v. Loyal Protective Insurance Co. 16,24,25
61 Idaho 677, 106 P.2d 1015
Reserve Life Insurance Co. v. Poole 18
(1959), 107 S.E. 2d 887
Russell v. Glen Falls Indemnity Co. 15, 16
134 Neb. 631, 279 N.W. 287
State Farm Mutual Auto Insurance Co. v. 24
Underwood, 377 S.W. 2d 459
Travelers Insurance Co. v. Murray 24
26 Pac. 774

TABLE OF STATUTES

PAGE

28 USC, Sec. 1732 28
28 USC, Sec. 1332 1
28 USC, Sec. 1291 1
Idaho Code Sec. 41-1839 7

TEXTS CITED

PAGE

75 ALR 2d 1243 18
84 ALR 2d, Annotation beginning page 176 19
86 ALR 354 23
108 ALR 1, Annotation 24
142 ALR 746 38
29 Am. Jur., Insurance, Sec. 1219, 1220 24
29A Am. Jur., Insurance, Sec. 1382 11

29A Am. Jur., Insurance, Sec. 1536, p. 642 23
4 C.J.S., Appeal & Error, Sec. 288 36
5A C.J.S., Appeal & Error, Sec. 1648 8
32 C.J.S., Evidence, Sec. 730(2) 28
45 C.J.S., Insurance, Sec. 939 23

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Appellee.

Appeal from the United States District Court for the District of Idaho

---

BRIEF OF APPELLEE

I. JURISDICTION

As is stated by Appellant, jurisdiction in the District Court was based on the provisions of 28 USCA Section 1332. The District Court found jurisdiction in its Pre-Trial Conference Order (R. 47).

This appeal is before the Court of Appeals on the Notice of Appeal and undertaking filed herein by Appellee (R. 222-223). Jurisdiction is conferred under 28 USCA Section 1291.

II. STATEMENT OF FACTS

This action was instituted by Appellee, Thomas J. Thompson, by occupation a working superintendent of heavy construction projects, for recovery of $50,000.00 claimed to be due from Appellant to Appellee pursuant to the terms of a total permanent disability policy issued by Appellant insuring Appellee for the period of September 1, 1963, to September 1, 1964. Appellee, as an eligible employee of Constructora Emkay, S.A., a subsidiary of Morrison-Knudsen Company, Inc., applied for the policy (R. 37-45, Exhibit 4) and was insured thereunder effective September 1, 1963. Appellee was at this time employed and working as a working superintendent on heavy construction tunnel work in Bogota, Colombia. The applicable portions of the insurance policy, so far as material to this action, are as follows:

> "TO INSURE such eligible persons who elect to become insured under this policy, herein called the Insured, against specified loss described in Part I—Description of Coverage resulting directly and independently of all other causes from bodily injuries caused by accident occurring while this policy is in force, herein called such injuries."
>
> . . . .
>
> "COVERAGE B — PERMANENT TOTAL DISABILITY: After one year of 'continuous total disability,' and if the Insured is

then 'permanently and totally disabled' the Company will pay a Permanent Total Disability Benefit equal to the difference between the Principal Sum and any payments made under Coverage A on account of such injuries.

" 'Continuous total disability,' which must result from such injuries and commence within 30 days after the date of accident, means the Insured's complete inability during the first year thereof to perform every duty of his occupation.

" 'Permanently and totally disabled," means the Insured's complete inability, after one year of continuous total disability as defined above, to engage in an occupation or employment for which the Insured is fitted by reason of education, training or experience for the remainder of his life."

. . . .

"This policy does not cover loss caused by or resulting from any one or more of the following:

. . . .

"D. Illness, disease, pregnancy, childbirth, miscarriage, bodily infirmity or any bacterial infection other than bacterial infection occurring in consequence of an accidental cut or wound,

. . . ."

Appellee, on September 9, 1963, was injured while working for his employer in a tunnel accident, the accident having occurred when he slipped on an oily surface, fell backwards and struck his neck on a steel collar (TR 23-24). Prior to going to Bogota, Colombia, Appellee was a healthy, robust, middle-aged man in good physical condition (TR 229, 253). He had followed heavy construction or worked in the mines all of his life (TR 11-19). He was accepted by Morrison-Knudsen Company, Inc., just before leaving for Colombia as being physically fit for heavy construction work. Following the September 9, 1963, accident Appellee was medically treated and hospitalized in Bogota, Colombia (TR 25-28). He returned to Boise, Idaho, on or about October 21, 1963. Following Appellee's return from Bogota, Colombia, his physical appearance and condition had materially and substantially deteriorated. He was very white, humped over, and could hardly walk (TR 230, 253, 254). After his return to Boise, Idaho, he consulted Jerome K. Burton, an orthopedic specialist, for extreme pain and discomfort in his neck, shoulder, arms and head, and during the course of the next several months was extensively examined by numerous physicians, surgeons and specialists, one of whom, Edward J. Kiefer, a neurosurgeon, recommended that he undergo a myelogram for diagnostic purposes. Administration of the myelogram is a usual and customary diagnotic procedure for back injuries where nerve involvement is suspected (TR 126). Appellee was given the myelogram at St. Alphonsus hospital on February 21,

1964, and as a result thereof, Dr. Kiefer diagnosed his difficulties as possibly a cervical disc protrusion possibly involving a nerve root or the spinal column (TR 294-295).

Shortly after Appellee was returned to his hospital room following the myelogram (about two hours) (TR 32), he got out of bed to go to the bathroom and felt immediate severe pain in both legs, which pain has persisted ever since (TR 57, 112), and was and is sufficiently severe as to be completely disabling within the meaning of the language of the insurance policy (TR 36-39, 68-74, 124-126). Following the myelogram on February 28, 1964, Appellee underwent an operation (cervical laminectomy) for surgical correction or improvement of the cervical disc protrusion (TR 296-302). This operation relieved to some degree Appellee's symptoms, but did not entirely correct them (TR 33).

Appellee, at various times prior to the accident of September 9, 1963, suffered other industrial accidents with various degrees of severity, but nevertheless, Appellee was fully capable of performing the duties of his occupation and employment at the time the subject policy was issued to him and at the time of the accident on September 9, 1963 (TR 22, 23, 34). Appellee throughout all his adult life had engaged, and at the time of the accident on September 9, 1963, was engaging in hard physical labor (TR 11-19), and by reason of education, i.e. eighth grade, and experience, was not qualified for any employment that did not involve a great deal of

physical effort. The injuries Appellee suffered prior to the injury of September 9, 1963, did not prevent Appellee from performing his usual occupation (TR 215-216).

Appellee was continuously totally disabled for the first full year after the September, 1963, accident and on or after that date Appellee mailed notice to Appellant that he claimed the benefits of the policy (Exhibit 19, R. 78). Appellee has, ever since the September 9, 1963, accident, been completely disabled from doing any work involving any material physical exertion whatever and is not educationally qualified or qualified by reason of experience to engage in any occupation other than active participation in heavy construction and mining employment. He is unable to be on his feet except for short periods of time. He is unable to sit for prolonged periods of time. He must lie down frequently (TR 260, 272, 274). He is nervous and shaky and unable to drive an automobile except for short distances (TR 32-33, 37, 69, 271-272). His physical condition is permanent and cannot be improved (TR 215). His total permanent disability is the result of the September 9, 1963, accident and medical treatment received for it (TR 278-279, 282).

At the trial of this cause the jury found for Appellee and the Court entered judgment for Appellee in the amount of $50,000.00, being the face amount of the policy of insurance. Following a special hearing the court awarded an additional $10,000.00 for attorneys fees pursuant to Idaho

Code, Section 41-1839, and the prayer of the Complaint.

III. ARGUMENT

1. *Summary*

Appellee's argument will consist of a brief introduction, an answer to each of Appellant's Specification of Errors, and an answer to the questions raised as reflected on Pages 32 and 33 of their Brief.

There are two primary issues in this case: (1) Whether Appellee is totally and permanently disabled within the meaning and language of Appellant's policy; and (2) whether Appellee's permanent total disability resulted directly and independently of all other causes from the September 9, 1963, accident and was not due to loss caused by or resulting from any one or more of the following: Illness, disease, or bodily infirmity.

Appellee maintains that the above issues involved disputed questions of fact upon which there was presented at trial substantial and competent evidence to support the propositions on behalf of Appellee that he was totally and permanently disabled within the language of the policy and that his disabilities resulted directly and independently of all other causes from injuries received in the September 9, 1963, accident.

There was a great deal of evidence presented by both sides in support of their respective positions and there is a great deal of substantial evidence to

support the jury's determination of the factual issues in favor of Appellee.

The responsibility of determining disputed questions of fact rests with the jury. Where there is substantial evidence, though conflicting, to support the verdict it will not be disturbed on appeal. 5A C.J.S., Appeal & Error, Sec. 1648; *Kent v. Campbell*, 80 Idaho 28, 324 P.2d 388.

We will now proceed to examine Appellant's Specification of Errors and in doing so, will first consider the numbered Specifications 1 through 28, following which we will consider, in the order presented on pages 32 and 33 of Appellant's Brief, the remainder of "Questions Presented."

2. *Specific Issues*

(a) Specification of Errors Nos. 1, 2, 3, 11, 12, 16, 22 and 28 are essentially the same and we will treat them together.

The substance of Appellant's claimed errors are that the court should have granted Appellant an involuntary dismissal, directed verdict, judgment notwithstanding the verdict, and a new trial because Appellant claimed that Appellee had injuries in his lifetime that contributed in whole or in part to his present total permanent disability.

The contention of Appellant was a disputed question of fact at trial. There was ample evidence to support Appellee's claim that the sole cause of his total permanent disability was the September 9,

1963, accident and the results of medical treatment necessary for diagnostic purposes. The injurious results of the medical diagnostic procedures related back to the September 9, 1963, accident. In order to have ruled that Appellee's permanent total disability was the result of other injuries, the court would have necessarily had to ignore the testimony of several witnesses that Appellee at the time of the accident was physically able to and was, in fact, fully performing the work required of him in his occupation. It would also have been necessary for the court to have added language to the exclusionary portions of the policy not therein contained.

(b) Specification of Errors Nos. 4 and 5:

Specification of Error No. 4 reads as follows:

> "The Court erred in giving Instruction No. 11, Para. 2, TR 423, reading,
> 'You are further instructed that legal notice and proof of loss were timely made,' "

The policy contains a provision as follows:

> "Notice of Claim: Written notice of claim must be given to the Company within twenty days after the occurrence or commencement of any loss covered by the Policy, or as soon thereafter as is reasonably possible. Notice given by or on behalf of the claimant to the Company at Philadelphia, Pennsylvania, or to any authorized agent of the Company, with information sufficient to identify the In-

> sured, shall be deemed notice to the Company."

No liability under Appellant's policy could have accrued until there had been 365 days of continuous total disability to perform every duty of his occupation. Therefore, any notice to the company prior to September 9, 1964, would be premature. Appellee's completed proof of loss form dated 9-9-64 and thereafter mailed to Appellant fully complied with the above provisions of the policy as well as the following provision:

> "Proofs of Loss: Written proof of loss must be furnished to the Company within ninety days after the date of such loss. Failure to furnish such proof within the time required shall not invalidate nor reduce any claim if it was not reasonably possible to give proof within such time, provided such proof is furnished as soon as reasonably possible and in no event, except in the absence of legal capacity of the Insured, later than one year from the time proof is otherwise required."

Further, Appellee did not file suit until January, 1965, which complied with the provisions of the policy entitled "Legal Actions," to-wit:

> "Legal Actions: No action at law or in equity shall be brought to recover on the Policy prior to the expiration of sixty days after written proof of loss has been furnished in accord-

ance with the requirements of the Policy. No such action shall be brought after the expiration of three years after the time written proof of loss is required to be furnished."

Furthermore, Appellant has shown no prejudice resulting from lack of notice. 29A Am. Jur., Ins., Sec. 1382, *Hope Spoke Co. v. Md. Casualty Co.*, 143 S.W. 85.

(c) Specification of Errors Nos. 6 and 8:

Appellant assigns error and much of its argument to the trial court's failure to give its Requested Instruction No. 4 (R. 157) (Specification of Error No. 8) and the court's giving in lieu thereof Instruction No. 13 (Specification of Error No. 6) and Instruction No. 16 (Specification of Error No. 11). The Requested Instruction reads in part as follows:

> "I instruct you that the accident insurance policy which plaintiff is covered by does not cover losses or disabilities which are brought about either *directly or indirectly, in whole or in part,* caused by resulting from any illness, disease, bodily infirmity . . ." (emphasis added)

The exclusionary provisions in the policy in question are not so defined. They read as follows:

> "This policy does not cover loss caused by or resulting from any one or more of the following:
>
> . . . .

D. Illness, disease . . . bodily infirmity . . ."

The words "wholly or in part, directly or indirectly" do not appear in the contract. It is true that they are frequently used in policies of this type. In fact, all of the cases cited in Appellant's Brief deal with words of limitation of this sort. They are not included in Appellant's Policy OKU 6303, however.

There is certainly a definite distinction between a policy which excludes death or loss wholly or partly, directly or indirectly, resulting from disease or bodily infirmity and one where only such bodily infirmity or disease as cause or result in death or loss are excluded.

This reasoning is consonant with the generally accepted rule of construction in insurance contracts favoring coverage and protection to the insured as opposed to denying coverage. In the type of exclusion chosen by and presented in Appellant's contract it excludes such death or loss as are caused or result from bodily infirmity or disease. Whereas, in the other type of policy the companies have meant to exclude any death or loss which in any way, even partially or indirectly, is caused by infirmity or disease.

If the trial court had granted Appellant's Requested Instruction No. 4, it would have added words of exclusion to the contract which did not exist. The court was perfectly correct in denying the same. To do otherwise would have been seriously prejudicial to Appellee and a misstatement of the

issues. The same may be said of Appellant's Requested Instruction No. 6 (R. 159), which is a further and like misstatement of the policy terms and the applicable law. What the court did instruct on the question of causation was as follows:

> Instruction 13 (TR 436)
> "In order to recover, the plaintiff must prove, by a preponderance of the evidence as in these instructions defined, each of the following:
>
> . . . .
>
> 4. That such disability resulted directly and independently of all other causes from bodily injuries caused by accident."

The court continues in Instruction 16 (TR 437) to state:

> "Evidence has been received of injuries suffered by the plaintiff prior to the accident of September 9, 1963. You may consider this evidence in determining whether or not the disability claimed by the plaintiff resulted directly and independently of all other causes."

Under these two instructions, if the jury were to find in favor of Appellee it had to conclude that the accident in question was the direct and independent cause of the disablity. Conversely, it necessarily had to find that the ensuing disability was not caused by or the result of either disease, bodily infirmity or previous injuries.

Taking the whole of the court's instructions, Appellee believes the issues were fairly presented to the jury. The court is not bound nor would logic direct that under its instructions it present the policy to the jury in haec verba. To dispell confusion and misunderstanding, it is permissible for the trial court to fairly reduce the contract in its view of the law and issues to terms more simple and understandable to the jury.

The Appellant has not shown error under Specifications 4, 5, 6, 11 and 12.

It is significant to note that Appellant has cited no case in which an instruction such as its Requested Instruction No. 4 has been given or its refusal found prejudicial.

All of the cases which are cited by Appellant in support of its contention in this point involve policy exclusions having broader definition and scope. Further, in each case there is present either an active pre-existing disease or bodily infirmity without which the loss or death would not have resulted.

The case of *Lado v. First National Life Insurance Co.*, 162 So. 579 (cited at page 60 Appellant's Brief), has no relevancy to the issues here. That case was resolved on a finding that insured died of a syphilitic condition of the aorta and valves of the heart. Death due to venereal disease was expressly excluded in the policy.

Moore v. Southern Life and Health Co., 195 S. 857 (cited at page 60 Appellant's Brief) is equally inapplicable.

The fact that Appellee may have suffered previous injuries resulting in abnormal physical differences would not prevent his recovery unless they directly caused the disability. See *La Barge v. United Insurance Co.*, 306 P.2d 380, where the Oregon Court stated:

> "Certainly, physical differences, as . . . render some more susceptible to the sustaining of crippling disabilities after trauma than others, but unless the differences are great enough in and of themselves to threaten imminent disability of the kind actually resulting, they cannot later be said to have been the cause of the disability." citing *John Hancock Mutual Life Insurance Co. of Boston, Mass., v. Crock*, 216 F.2d 805 (CCA 4th)

Moreover, it is noted that in the case of *Russell v. Glen Falls Indemnity Co.*, 134 Neb. 631, 279 N.W. 287, cited by Appellant, the following Instruction No. 5 given by the trial court was cited in the appellate court's opinion without any criticism whatever:

> "The burden is upon the plaintiff to establish by a preponderance of the evidence the following propositions:
>
> . . . .
>
> (3) That injury and deafness was caused solely from such claimed accidental means directly, independently and exclusive of all other causes."

What the appellate court did find objectionable, however, was a subsequent instruction which gave the jury liberty to find in favor of plaintiff in spite of the fact that it might find that death resulted from direct aggravation of a pre-existing disease (deafness). This was clearly a misinterpretation of the policy provision, but had the trial court in the *Russell* case deleted this instruction and added one similar to Instruction No. 13, i.e. that the jury could consider plaintiff Russell's pre-existing deafness and infirmity in determining whether his disability resulted directly and independently of all other causes, there would seemingly have been no reversible error.

Brief comment will be made in the Appellant's case of *Davis v. Jefferson Standard Life Insurance Co.*, 73 F.2d 330 (cited pages 53 and 60 Appellant's Brief). A portion of the opinion is set out at page 53 of Appellant's Brief. When read in its true context we see that the statement quoted by Appellant is dictum and not necessary to the result as the court found that the insured died as a direct result of a weakened heart.

It is true that courts cannot extend coverage beyond the terms of the policy. For the Appellant to imply from the quoted portion of the *Davis* case that construction and interpretation of the policy are to be limited in favor of the insurer is, however, contrary to law.

Support for liberal rather than conservative construction can be readily found. In *Rauert v. Loyal*

Protective Insurance Co., 61 Idaho 677, 106 P.2d 1015, we find the following:

> ". . . For this reason the rule of *strictissimi juris* has been applied almost universally to insurance contracts, and this jurisdiction, like many others, has declared in favor of a liberal construction in favor of the insured to accomplish the purpose for which the insurance was taken out and for which the premium was paid."

The following excerpt from this court's opinion in *New York Life Insurance Co. v. Wilson*, 178 F.2d 534, is pertinent to this question:

> "The policy exclusions to be considered under the second question are, specifically, those where death results directly or indirectly from infirmity of mind or body, from illness or disease. We understand it to be the general view that provisions of this sort are strongly construed against the insurer, and that indemnity for death from accident covers death resulting from bodily infirmity or disease directly attributable to and proximately caused by the accident."

We wish to emphasize that in the *Wilson* case the policy exclusions were those not only directly caused or resulting from disease or infirmity, but those "indirectly" as well. A fortiori, when as in the Appellant's policy the words indirectly, partially, etc., do not appear.

The term "infirmity" has been construed as being practically synonomous with disease so far as they relate to some body impairment or disorder. To amount to an infirmity within the meaning of the exclusions of an accident insurance policy the condition must be of a substantial character sufficient to impair in some material degree the insured's health and well-being. 75 ALR 2d 1243.

In *New York Life Insurance Co. v. McGehee* (1958 CA5 Ala), 200 F.2d 768, we find the following statement:

> "A review of the Alabama cases and the decisions of this Court shows that considerable latitude must be allowed the jury in determining the question of causation. An insurer cannot escape liability simply by showing that some disease may have contributed to some extent to the insured's death . . . If an insured has an active disease of such a character as to endanger the insured's life, apart from the accident, such a disease is a contributory cause that will bar recovery. If, however, an injury starts a chain reaction resulting in death, recovery may be allowed even if one of the links are dormant diseases or physical conditions without which the chain would be broken."

See also *Reserve Life Insurance Co. v. Poole* (1959) 107 SE 2d 887, where the court affirmed a judgment for plaintiff notwithstanding evidence that plaintiff's disability was due to a cooperation

of the accident and a pre-existing arthritic condition, the court stating:

> ". . . if the plaintiff's physical condition was such that while he was in some respects in less robust health than another man of his age might have been, so that he was more susceptible to disability on account of the injury he received as a result of the accident, although another not suffering from a similar weakness would not ordinarily have suffered a disability as a result of such an accident, he may nevertheless recover."

In *La Barge v. United Insurance Co.* (1958) 209 Oregon 282, 303 P.2d 498 (on rehearing 306 P.2d 380), the insurer unsuccessfully sought to avoid liability under double indemnity insurance on grounds that the insured's arthritic condition cooperated with the accident causing death. The court held that abnormalities and infirmities of the insured are to be considered dormant and not to exclude coverage where the insured is able to go on about his daily activities and earning his livelihood.

For an exhaustive treatment of the subject see 84 ALR 2d, annotation beginning page 176.

Appellee believes these foregoing authorities reflect the more logical, reasonable and most current construction followed by the courts in matters involving insurance contract provisions of the nature now present. The law to be applied here is that expressed by this court in *New York Life Insurance*

Co. v. Wilson (supra). Accordingly, Appellant's Requested Instruction No. 4 (TR 157) was an inaccurate statement of the applicable law and was properly rejected by the trial judge.

The court's charge to the jury that Appellee must establish by a preponderance of the evidence that his disability, if found to exist, resulted directly and independently of all other causes from injuries sustained in the accident and that the jury should consider the Appellant's evidence of previous injuries in determining the question of direct and independent causation, was an accurate presentation of the law of the case.

(d) Specification of Error No. 7:

Appellant objects to the court's Instruction No. 13 because the instruction would allow the jury to find Appellee's "total and permanent disability from performing in the usual and customary manner an occupation or employment for which he is fitted by reason of his training, experience or education for the remainder of his life" began within 365 days rather than after 365 days from the accident. Under the facts of this case the error, if any, was harmless since the evidence is clear that Appellee was permanently disabled within both definitions under the policy from the time of the accident on September 9, 1963, and he made no effort to make proof of loss until after the expiration of one full year.

(e) Specification of Errors Nos. 9 and 10:

Appellant complains of the court's failure to give its Requested Instruction No. 5 in which it requests the trial court to define an accident as follows:

> "You are hereby instructed that the term 'accident' as used in the policy is defined as an act which is not natural or probable and should not reasonably, under all of the circumstances, have been foreseen, and is tragically out of proportion to the trivial cause."

The court rejected this definition and gave instead Instruction No. 15, leaving off of the language of Requested Instruction No. 5 the following words: "and is tragically out or proportion to the trivial cause."

Appellant cites as authority *O'Neil v. New York Life Insurance Co.*, 65 Idaho 722, 152 P.2d 707. This case involved interpretation of double indemnity life policy which excluded death *resulting from insured's committing an assault or felony.* Insured died as a result of injuries received in an altercation. The court found that "if the result of an act was not natural and probable and should not reasonably, under all the circumstances, have been foreseen and it is tragically out of proportion to a trivial cause, it is an accident within the meaning of the above quoted provisions of the insurance contracts in question." The phrase "and is tragically out of proportion to a trivial cause" was added to the common and accepted definition of the term accident as used by the court below in its Instruction No. 15 to suit particular facts and contract provisions not present

in the case at bar and moreover, for the express purpose of broadening that meaning in order to cover the unusual death of the insured.

The phrase is not applicable to the facts at bar and, therefore, Instruction No. 15, giving the accepted definition of the term "accident," was sufficient and without any prejudice to Appellant.

A fortiori, the *O'Neil* case held the burden of proof was on the insurer to show that the death of insured was within one of the exceptions contained in the policy. Citing *Mober v. Continental Casualty Co.*, 37 Idaho 667, *New York Life Insurance Co. v. Jennings*, 6 S.E. 2d 431, *Mah See v. North American Acc. Ins. Co.* (Calif) 213 Pac. 42.

(f) Specification of Errors Nos. 13, 14, 15 and 17:

Appellant objects to the court giving the following instruction (Instruction No. 17, TR 437)

> "If you find that the plaintiff suffered an accident on September 9, 1963, resulting in injury to his cervical spine, you are instructed that the plaintiff was under an obligation to submit to reasonable medical treatment in order to alleviate the injury and minimize the possibility of any disabling effects therefrom."

and Instruction No. 18 which reads as follows:

> Instruction 18 (TR 437)
> "If you find that in February, 1964, the plaintiff underwent myelographic studies and a

> surgical operation of his cervical spine and that such myelographic studies and surgical operation were, from a medical standpoint, necessary to deal with the effects of the injury suffered by the plaintiff on September 9, 1963, and if you further find that the effects of either said myelographic studies or surgical operation resulted in or contributed to the plaintiff's present disability, you are instructed that the consequences following the myelographic studies and the surgery are to be regarded by you the same as though they had followed the injury of September 9, 1963, without any intervening medical treatment or surgery."

Appellant claims in substance that a bizarre or unusual result of the myelographic studies would constitute a separate accident. Appellant cites no authority in its argument on any of the above Specifications. The court's instruction was a correct statement of the law.

The insured under an accident and disability insurance contract who has suffered an injury within the coverage of the contract must submit to reasonable medical treatment to minimize any resulting disability. 29A Am. Jur., Ins., Sec. 1536, p. 642; 45 C.J.S., Ins., Sec. 939; *Cody v. John Hancock Mutual Life Ins. Co.*, 163 S.E. 4; 86 ALR 354; *Culver v. Prudential Ins. Co. of America*, 179 A. 400; *Mutual Life Ins. of N. Y. v. Knight*, 178 S. 898.

Where a surgical operation becomes necessary to properly treat the effects of an injury within the coverage of an accident insurance contract and the insured dies or becomes totally disabled as a result of the operation or treatment, such death or disability results independently of all other causes from such injury although the death or disability is due to some latent infirmity or a cause wholly unrelated to the injury. *Rauert v. Loyal Protective Ins. Co.*, 61 Idaho 677, 106 P.2d 1015; *Ballam v. Metropolitan Life Ins. Co.*, 3 N.E. 2d 1012; *Collins v. Casualty Co. of America*, 112 N.E. 634; 108 ALR 1, Annot.; *State Farm Mutual Auto Ins. Co. v. Underwood*, 377 S.W. 2d 459; 29 Am. Jur., Ins., Sec. 1219, 1220; *Gardner v. United Surety Co.*, 125 N.W. 264; *Travelers Ins. Co. v. Murray*, 26 Pac. 774.

Appellant denies that the effects of the myelographic study should relate back to the accident of September 9, 1963. It has cited cases in support of its contention which involved extremely unusual circumstances and unrelated events in support of this theory, such as where a portion of the ceiling collapsed in the operating room severely injuring the insured. Appellee submits such cases are not applicable to the facts in the case at bar. There is competent and substantial evidence in the record that the myelographic study was a proper and necessary diagnostic treatment of the condition from which the Appellee was suffering. There is substantial evidence that the results of the myelographic study and its disabling effects are, although unusual, a

hazard and risk which may be expected from the effects of the opaque dye in the spinal column (TR 127; TR 280, 281; TR 381, 382).

Support for Instruction Nos. 17 and 18 are found in the Idaho case of *Rauert v. Loyal Protective Insurance Co.* (supra). There the trial court refused requested instructions of the insurance company similar to Appellant's Requested Instruction Nos. 4 and 17 (Specification of Errors Nos. 8 and 16), and gave instead the following Instruction which was approved by the Supreme Court of the State of Idaho:

> "You are instructed that if you find from the evidence that William Rauert received an accidental injury commonly known as hernia or rupture and that such injury was the active efficient cause which set in motion and introduced other agencies, including septicaemia, which resulted in his death without the intervention of any other independent force, then and in that event the said injury so commonly known as hernia should be regarded as a sole and proximate cause of his death."

The "septicaemia and other agencies" mentioned in the instruction were the effects and the results of the operation performed on the insured following and occasioned by the hernia. This is clearly analogous to the case at hand.

(g) Specification of Errors Nos. 18 and 20:

Appellant complains that he was not allowed to show Appellee's salary while he worked overseas. There was a full description of Appellee's education, abilities, prior work and experience in the record and what he was paid for what he had done in the past was neither relevant nor material. His ability to perform his occupation was the issue—not what he had in the past been paid. The court was entirely correct in rejecting the offered proof.

Specification of Errors No. 18(b) and 20(a) concerned an attempt by Appellant to ask Appellee about statements in the verified Complaint to which the trial court sustained an objection on the ground that such pleadings were superseded by pre-trial orders. Furthermore, there was nothing inconsistent anywhere in Appellee's testimony or that of other witnesses for Appellee with what appeared in the verified Complaint. The statements in the Complaint were not inconsistent with Appellee's testimony.

Specification of Errors Nos. 18(c) and 20(b). Appellant objects because he was not permitted to ask Appellee about pleadings filed before the Industrial Accident Board concerning the combination of Appellee's various prior injuries with the injury of September 9, 1963, contributing to total disability. The court's refusal to admit the testimony was proper for the reason that under Workman's Compensation laws all previous disability awards and disabilities must be taken into consideration in

determining an employer's liability. Further, under Workman's Compensation laws permanent disability means a complete disability to enter into any gainful occupation which is not the test in this case. The court, by its ruling, simply prevented the Appellant from injecting Workman's Compensation issues into a contractual case based on an insurance policy and prevented the trial from being sidetracked into the trial of other issues, to-wit: The various legal differences attendant to pleading a Workman's Compensation case and a case under Appellant's policy. Besides, when viewed in light of Workman's Compensation laws, there was nothing inconsistent with Exhibit 10 and Appellee's testimony or pleadings in this trial.

(h) Specification of Error No. 19:

This specification concerns the admissibility of Appellee's Exhibit No. 20 which was a medical report of Appellee's physical condition just prior to his departure for overseas to take the job he was performing when injured.

The witness, Alfred J. Goade, testified (TR 243-246) to be the manager of administration and accounting for Morrison-Knudsen Company, Appellee's employer, through which the Appellant's policy of insurance was issued. He stated that the medical report was a business record kept and maintained in the normal course of his employer's business; that it was prepared following Appellee's physical examination preparatory to his employment overseas; that he knew of his own knowledge that it was the

records from the files of Morrison-Knudsen Company.

28 USCA 1732 provides:

> "(a) In any court of the United States and in any court established by Act of Congress, any writing or record, whether in the form of an entry in a book or otherwise, made as a memorandum or record of any act, transaction, occurrence or event, shall be admissible as evidence of such act, transaction, occurrence or event, if made in regular course of any business, and if it was the regular course of such business, to make such memorandum or record, at the time of such act, transaction, occurrence or event or within a reasonable time thereafter.
>
> . . . ."

That a medical report furnished an employer by the examining physician made in regular course of business is admissible where otherwise relevant cannot be denied. 32 C.J.S., Evidence, Sec. 730(2); *Landon v. U.S.*, 197 F. 2d 128.

The evidence was uncontradicted that (1) the report was made in the normal course of business, and (2) that it was normal to keep such record in connection with the employer's business.

Neither the Federal rule nor the Idaho rule on business records require the custodian of the records to make identification; any qualified witness may do so.

Appellee does not maintain that the medical report was a physician's business record as Appellant's argument would imply. Consequently, much of that argument is irrelevant. Moreover, there was ample evidence from other sources, witnesses, etc., uncontradicted which showed Appellee was in good robust health at the time of the examination reflected by Exhibit 20. Also, evidence of his good condition is corroborated by fact that Appellee did, in fact, well perform the tasks of his employment.

Exhibit 20 was cumulative of the fact it represented and certainly no prejudice could have arisen from its admission.

(i) Specification of Error No. 21:

Appellant alleges misconduct on the part of the trial court consisting in showing of favoritism to Appellee and cites the instances following:

TR 246, wherein the court, in response to Appellant's objection that an offered exhibit was heresay, queried Appellant's counsel as to whether he wished a recess so that another company officer having actual physical custody of the document could be called for purposes of identification of the exhibit. The heresay objection by Appellant's counsel was a highly technical one and not the proper objection to the question asked. It is obvious from reading the transcript at this point that the court had concluded that Appellant's other objections to the exhibit would not be allowed. The issue the trial judge was trying to resolve was whether Appellant's coun-

sel was going to insist upon delaying the trial to cure a technical defect. The court recognized that there was a proper objection that could have been interposed, to-wit: no proper foundation or identification. The defect, if any, obviously could be cured but would result in taking considerable of the court and jury's time. Certainly interjections by the court from the standpoint of expediting the trial and preventing unreasonable and unnecessary delays is a proper function of the trial court. A portion of the court's remarks at this point were made necessary by reason of Appellant's counsel not replying for some time to the court's question, reflected in the following portion of the transcript, TR 244-245:

> "MR. EBERLE: We object to the exhibit, Your Honor, as heresay.
>
> "THE COURT: Very well, do you want to take a recess while we call the proper officer?"

Appellant's counsel did not answer this question except finally after repeated queries by the court. Appellant's counsel in the first instance did not raise the proper objection and the court, in pointing out in effect to Appellant's counsel that identification of the exhibit (i.e. foundation for its admission) was the proper objection, was, if anything, assisting him. Appellant states in its Brief on page 94 "that the Court required Appellant's counsel to state the objection for the third time, that no proper foundation or identification had been made." This is

not the case because Appellant's counsel never did make the proper objection and the matter would probably never have been raised had the court not assisted Appellant's counsel in pointing out the correct objection. Appellee does not complain of the fact that Appellant's counsel may have been helped by the court's remarks for the reason that it is obvious that the court was simply trying to prevent unjustified delay of the trial on purely technical grounds. This we believe to be a proper function of trial judges.

Appellant next objects to the court asking Appellee if he wanted a glass of water (TR 30). What does not appear of record, of course, is the physical condition of Appellee as he was testifying. Certainly, if the trial court, based on his own observation, felt that a party or witness in the courtroom was in physical need of aid he may offer that aid without committing prejudice to either side. Had Appellant at the time felt that the court was not justified in offering water to Appellee, he should have said so; otherwise, how would the physical circumstances or need of Appellee, or lack thereof, ever become a part of the record.

Appellant claims the court's remarks on pages 50 and 51 of the transcript to be prejudicial to him. There was nothing said by the court that could possibly be construed as prejudicial to the Appellant. Appellant was permitted to ask the witness what he wanted to ask him and the court merely attempted to clarify Appellant's counsel's question.

The court also remarked that everyone would have to speak up and speak clearly and asked that both sides ask easier questions so that Appellee, by reason of limited vocabulary, could understand them. It is obvious from Appellee's testimony that his education was limited, i.e. an eighth grade education (TR 11), and his hearing, to some extent, defective, and the request by the court was in all respects a fair one. The court had an opportunity to observe the witness and his difficulty in hearing and understanding, and in view of these factors, any criticism of the court is not justified.

Appellant complains of the court suggesting to Appellee's counsel grounds for objection to an exhibit offered by Appellant (TR 84). Appellee's counsel, rather than stating the proper grounds for objection, had begun stating reasons and argument for his objections. The court cut Appellee's counsel short and properly so, and stated the grounds he would accept. The exhibit being offered was so obviously inadmissible that no prejudice could have resulted to Appellant from its rejection. Counsel for Appellant was attempting to get before the jury records of other litigation where the basis for liability (Workman's Compensation) and the meaning of permanent disability is entirely different than the basis for liability and permanent disability definition in this case. The court is not required to sit idly by and permit either side to present evidence to the jury that is not legally admissible, the effect of which would be misleading and highly prejudicial.

Appellant next complains as to the court's suggesting a way to Appellee's counsel to rephrase a question (TR 117-118) without ruling on the objection. Under the circumstances, this was proper since following the objection Appellee's counsel immediately withdrew the question objected to by stating, "I will rephrase the question." Appellant's counsel had, in stating his objection, pointed the way to rephrase the question and the court simply elaborated on it. We are unable to detect any prejudice in the court's remark or see how it could be construed as prejudicial.

Appellant next complains of the court's suggestion that Appellee's counsel use the word "irritation" rather than "allergy" in a question to which there had been an objection (TR 405). The suggestion was not taken by Appellee's counsel and no harm resulted to Appellant. Further, the court again was merely trying to expedite the trial rather than let it be unnecessarily delayed. Again, no prejudice resulted.

Appellant next states that the court prevented Appellee from testifying to offered Exhibits 8, 9 and 11 (TR 81). This is a misstatement of what took place. In fact, the court actively assisted Appellant's counsel in getting his evidence in the record. Appellant's counsel stated on page 80 of the transcript that he was offering the exhibits to show the percent of disability in each case. Thereafter the court solicited and obtained from both counsel a stipulation as to the percent of disability Appellant

wanted to show and allowed into evidence three of Appellant's exhibits over Appellee's objections. Appellant was helped and not harmed by the court's participation.

Appellant also claims the court should not have made the remarks appearing on pages 192 and 193, lines 1-4, of the transcript. The court, on its own, corrected facts stated by Appellant's counsel in a previous question. The statements made by Appellant's counsel, (TR 192, lines 8-14) were not accurate statements of testimony previously in the record. Appellee's counsel should have objected and didn't. However, Appellant's real complaint is that the court, on its own, would not allow him to misstate the testimony. This is hardly a legitimate basis for claiming prejudicial conduct on the part of the court.

Appellant further asserts that there was no single instance where the same thing (apparently meaning any of the above) was done for Appellant by the court. This is not correct, for example, TR 100, lines 4-9, wherein the court advised Appellant's counsel how he might ask a question, and the assistance rendered Appellant's counsel in connection with the stipulation as to percentage of disability reflected by Exhibits 8, 9 and 11.

The trial of this case lasted 3½ days, 3 days of which were devoted primarily to taking the testimony of witnesses. Appellant has examined the record with a fine-tooth comb and has cited a few isolated instances wherein it alleges the court was

not entirely impartial, although it made no objections to this alleged impartiality at the trial. In support of this allegation of impartiality the Appellant has cited cases (*Mason v. United States*, 63 F.2d 791, *Goldstone v. Rustemeyer*, 21 Idaho 703, 123 Pac. 635, *La Chase v. Sanders*, 142 Conn. 122, 111 A.2d 690, *Coulson v. Wenzel Hotels, Inc.*, 248 Ill. App. 540, and *Hays v. Viscombe*, 122 Cal. App. 2d 135, 264 P.2d 173) wherein the trial judge, under the various factual situations, became an advocate in the case, criticized counsel and the case, made prejudicial remarks, made constant interruptions of counsel, inferred that a party was making a false claim, virtually directed a verdict for one of the parties through comments, and numerous other instances of actual misconduct, none of which are present in this case.

In the case before the Court a great amount of testimony was taken with few objections being made and with relatively little, if any, comment from court or counsel. The trial judge made every reasonable effort to eliminate prejudicial or improper evidence from being brought to the attention of the jury and made every reasonable effort to assist counsel on both sides when an objection was raised by stating, in effect, what portion of the matter involved in a particular question he would not permit and suggesting to counsel what he might or would permit if the question were asked. Not once did he criticize either counsel, witness or party, nor was he discourteous to anyone. He would not permit un-

necessary or unreasonable delay of the trial, nor allow inadmissible prejudicial evidence to be presented to the jury. Both sides were given full and fair opportunity to present their cases and the entire record reflects that both parties received a fair and impartial trial.

It is a well settled rule that in the absence of a proper and timely objection thereto in the lower court, alleged improper conduct or remarks on the part of the trial judge will not be reviewed.

4 C.J.S., Appeal & Error, Sec. 288

Appellant seems to admit that in no specific instance did the court below make remarks or exhibit conduct prejudicial. Appellant seems to rely on an accumulation of matters which evidenced bias on the trial judge's behalf. No objection to such alleged remarks or conduct was made by appellant at the time of trial. A case in point is *Metzenbaum v. Metzenbaum* (Calif), 214 P.2d 603. There the Appellant likewise contended that remarks and conduct on the part of the trial judge indicated his bias and prejudice against them. No objections were made at the time of trial. The court refused to review the same stating in part:

> "If the harmful result of the misconduct of the trial judge can be obviated by bringing the matter to his attention, as a predicate to claiming error on appeal, an assignment of such misconduct must be made in the trial court."

The court then reviewed statements and conduct on the ground that the accidental death or loss is of here, and found "that in no instance was the remark of the trial judge of a nature the prejudicial effect of which could not have been removed if the matter had been called to his attention."

The cases cited by Appellant in support of its position are clearly distinguishable from the case at bar. In each case there was a showing of either, and sometimes both, sharp criticism of an Appellant's counsel and cause and statements to the jury which amounted to directed verdict on issues of fact which were in dispute between the parties.

(j) Miscellaneous Issues:

Appellant misstates the Appellee's burden of proof. Appellee was required to prove that he was totally and permanently disabled within the language of Appellant's policy and that such disability resulted directly and independently of all other causes from an accident, which necessarily means, and the trial court so instructed, that the disability could not result from illness, disease or bodily infirmity. If Appellant maintained that Appellee's injuries were the result of illness, disease or bodily infirmity, Appellant had the burden of so showing. Appellant, throughout the course of all these proceedings, has attempted to shift this burden of proof to the Appellee.

The Idaho Supreme Court held in *O'Neil v. New York Life Insurance Co.*, 65 Idaho 722, 152 Pacific

2d 707, that where the insurer seeks to avoid liability on the ground that the accident death or loss is within one of the exceptions of the policy the burden is on it, not the insured, to prove facts bringing the case within the exception.

And in 142 ALR annotation Page 746 appears the following statement on this issue:

> "Although there appears to be some authority to the contrary * * * the rule supported by the overwhelming weight of authority, in cases involving accident policies or other policies with accident features containing express conditions or exceptions excluding or limiting the coverage of the policy as to an injury or death which would otherwise be within such coverage, is that the burden of proving that the insured's injury or death was within such conditions or exceptions is on the insurer, and that the plaintiff is not under any burden of negativing application of such exceptions or conditions."
>
> See also *New York Life Insurance Co. v. Wilson* (9th Cir.) 178 F 2d 534.

A great deal of evidence was produced by Appellee to support the jury's finding that Appellee's disability resulted directly and independently of all other causes. The burden of proof was on Appellant to show that the injuries caused by the accident of September 9, 1963, was within the exclusions of the policy for illness, disease, bodily infirmity, etc.

Without attempting to set out the great volume of testimony in the record from which the jury found that Appellee did sustain his burden of proof, to-wit: that the bodily injuries resulted directly and independently of all other causes from the September 9, 1963, accident, we will briefly summarize it as follows:

The testimony of Appellee (TR 11-19, 22, 51), his wife Laura Thompson (TR 267-268), Robert Hobson (TR 229-232), James G. Roche (TR 251-252), John Ward (TR 256), and Dr. Jerome Burton (TR 104-105) all sustain the proposition that Appellee was a robust healthy man capable of performing heavy construction work before going overseas, and that upon his return he was in very poor physical condition (TR 106-108, 230-231, 253-254, 259-260). The medical testimony of Dr. Franklin C. David (TR 214-216), Dr. James J. Coughlin (TR 278-279), Dr. M. B. Shaw (TR 180, 205), and Dr. Jerome K. Burton (TR 125) all attribute his disability to the September 9, 1963, accident or to the combination of the accident and effects of the myleographic diagnostic procedure (TR 282-285), and that such injuries totally and permanently disabled him from performing his occupation (TR 125, 278-279). There is a great abundance of testimony in the record, portions of which have been heretofore referred to by transcript references, to sustain Appellee's contention and the jury's finding that Appellee's total disability as defined in the policy resulted directly and independently of all other causes from the accident of September 9, 1963.

Appellant next raises the question:

> "If Appellee's proof meets said burden, did Appellee meet the burden of proof that after the existence of one year of continuous total disability commencing within 365 days after the accident of September 9, 1963, he was totally and permanently disabled from engaging in an occupation or employment for which he might be fit by reason of education, training or experience?"

We refer to our references throughout this brief to testimony illustrating the extent of Appellee's disability.

Finally Appellant raised the following question:

> "Was the action of the Court in ruling on evidence during the trial, and in ruling on the motions for voluntary dismissal, directed verdict, judgment notwithstanding the verdict, and new trial prejudicial error?"

This we feel is inclusive of all Appellant's specific assignments of error individually covered and refuted in this brief.

Appellant maintains that the hospital chart (Exhibit 6) does not support Appellee's claims of leg pain following the myleogram. However, the hospital chart definitely shows that on at least two instances there was mention in the chart of Appellee's leg pain (TR 161-162, 195-196, 310). Of course the fact that Appellee was almost constantly under

medication for pain while in the hospital needs to be considered since he would be less likely to have complained if his pain was suppressed by drugs. The hospital chart does show considerable pain medication being administered to Appellee during his hospital stay as well as definite references to leg pain following the myleogram (Exhibit 6), (TR 161-162).

3. *Conclusion*

Appellant has cited numerous alleged errors of the trial court, not only in his instructions, failure to give instructions and rulings on evidence, but also in his conduct and manner of handling the trial. However, nowhere in the record or in Appellant's Brief is there any explanation, reason or illustration of how or in what manner anything that occurred at the trial prejudiced Appellant. The issues in this case were primarily factual, both sides had full opportunity to present all relevant and material evidence, and we submit that the jury, from all evidence before it, rightly concluded that Appellee was fully capable of and was performing hard physical labor when he took out Appellant's policy and that after he suffered the accident of September 9, 1963, he was not qualified by reason of the accident, to do any work, and that he became and is totally and permanently disabled within the definitions of the policy.

CERTIFICATION

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Theron E. Roberts

Attorney

ROBERTS & POOLE
Boise, Idaho

No. 20822

In the

United States Court of Appeals For the Ninth Circuit

INSURANCE COMPANY OF NORTH AMERICA
a corporation

Appellant,

vs.

THOMAS J. THOMPSON,

Appellee.

Appeal from the United States District Court for the District of Idaho Southern Division

REPLY BRIEF OF APPELLANT

RICHARDS, HAGA & EBERLE
711½ Bannock St.
Boise, Idaho
Attorney for Appellant

No. 20822

In the
United States Court of Appeals
For the Ninth Circuit

INSURANCE COMPANY OF NORTH AMERICA
a corporation

Appellant,

vs.

THOMAS J. THOMPSON,

Appellee.

Appeal from the United States District Court
for the District of Idaho
Southern Division

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SUBJECT INDEX

PAGE

TABLE OF CASES i

I. FACTUAL ISSUES 1

II. FURTHER LEGAL ARGUMENT 10

TABLE OF CASES

Bergholm vs. Peoria Life Ins. Co.
284 US 489, 52 Sup. Ct. 230, 231, 76 L. Ed. 416 14

Evans vs. Continental Life and Accident Co.
88 Idaho 254, 398 P.2d 646 ..... 11, 12, 16, 17

Kinglands vs. Metropolitan Life
97 Mont. 558, 37 P.2d 335 17

McNutt vs. Hughes Construction Co.
176 So. 2d 315 (Ct. App. La. 1963) 23

Metropolitan Life Insurance Co. vs. Rosier
189 Okl. 448, 117 P.2d 793 16

New York Life vs. Wilson
178 F.2d 534 ..... 12, 20

O'Neal vs. New York Life
65 Idaho 772, 152 P.2d 707 12

Rauert vs. Loyal Protective Insurance Co.
61 Idaho 677, 106 P.2d 1015 ..... 16, 17, 19, 20

Russell vs. Glens Falls Indemnity Co.
134 Neb. 631, 279 N.W. 287 19

Tschida vs. Continental Casualty Co.
246 N.Y. Sup. 2d 72 at 76 22

U.S. Fidelity & Guaranty Co. vs. Blum
270 F. 946 16

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REPLY BRIEF OF APPELLANT

The reply brief of appellant will discuss first the inaccurate statements of fact in appelle's brief, and then reply to the questions of law and the argument raised by appellee's brief.

I FACTUAL ISSUES

Either directly, or by implication, certain portions of the appelle's brief are in error. On Page 2, it is stated that the appellant insured the appellee for a full year, throught September 1, 1964. The policy was is-

sued for a full year, to Morrison-Knudsen Company, Inc., and its affiliates, but it is uncontradicted in the evidence that the insurance application of the appellee was effective September 1, 1963, and expired October 31, 1963. The premium was paid for two months only and no coverage existed after said expiration date.

Appellee on Page 4 of his brief states that appellee was "accepted by the company as being physically fit for heavy construction work." Appellee cites no folio for such statement, and in fact it is not correct. No employment official of the company appeared, the only witness being the manager of the accounting department. Further, there is no evidence in the record of what the standards which had been established by said company for overseas duty as to physical fitness may be. Finally, objection was certainly made to Exhibit 20, allegedly a medical report, in which the doctor made certain statements wholly unrelated to an examination, but being conclusory in nature. There was no evidence that this particular doctor made the examination for Morrison-Knudsen or as an independent physician, of whether he knew where the appellee might be going overseas which certainly would affect his ability to judge whether he was physically fit, nor was there any evidence of whether the company acted on the basis of the medical report. Further it was made in the summer of 1962, prior to two other accidents which occurred before the September 1963 accident. As is very carefully set forth in appellant's brief, the medical report, Exhibit 20, was improperly admitted into evidence over objection and was highly prejudicial. This is discussed further below.

Somewhat amazingly, appellee not only misstates the nature of the cervical injury and surgical correc-

tion thereof, but never answers the point raised by appellant's brief on this. Thus, on Page 5 of appellee's brief it is stated that the operation performed on appelle was for "correction or improvement of the cervical disc protrusion." A major point made by appellant was that there was a hard, bony, and therefore very old, cervical disc protrusion at C-7 level, as well as evidence of one at the C-6 level. The second point made was the existence of well defined osteophytes in the area of the C-7 and elsewhere in the cervical spine. Even though Dr. Burton, appellee's expert, both in his presurgery and his post-surgery diagnosis, and the proof of loss to appellant, claimed a broken spinus process and a ruptured cervical disc that had been removed, both appellee's orthopedic surgeon witness and all the doctors for the appellant contradicted him. In fact, the operation found nothing broken and was merely a removal of the posterior section of the lamina in the C-7 area, so that the difficulty being created by the very old, hard, protruding disc impinging against the old osteophyte areas of the lamina no longer irritated the nerve root. There was no correction of the disc for very sound, and uncontested diagnostic reasons given at the trial. The uncontradicted evidence was that while the Septem 9 fall irritated the existing condition of the cervical spine, but for the existence of the preexisting protruding discs and osteophytes, the irritation and pain from the fall would have been transient. The evidence was uncontradicted that the nature of the hard disc and the osteophyte was such that their development had occurred over a number of years. It is clear that these were not minor conditions or conditions of a normal person of the age of appellee, and that they are conditions that would continue to develop and cause irrita-

tion. Therefore, it is amazing that appellee does not explain how the alleged disability could arise from the September accident in light of these obvious preexisting infirmities and be within the policy's terms which exclude them.

Likewise, on Page 5 of the brief, the last major paragraph, it is startling to find appellee avoiding the basic issue of the case with his statement that at the time the policy was issued appellee was fully capable of performing the duties of his occupation. An examination of the folios cited shows only the bare statement by the appellee that although his hands were tender from burns of the May accident requiring the wearing of gloves that he "... was able to do (his) job." (TR 34). There is no other statement as to being fully capable of doing his duties. Of course, the facts shown elsewhere in the record, and cited by appellant in the description of the various accidents that occurred to him prior to the September accident, clearly show to the contrary. Briefly, these were a major impairment of his hearing which made heavy construction work hazardous, a major pulmonary disability from the May fire which even prior to the September accident was causing him shortness of breath in any minor distance walked, his inabilities to bend over and touch much below his knees, and the various internal conditions as previously noted. In any event, the question is not whether at a point in August 1963, he was able to do certain work, but whether as a result of the accident of September 1963 he is unable to do any work (as distinguished from what he had been doing) within his knowledge and training. Certainly the statement in the brief is a misstatement of the actual evidence.

In the same area on Page 5, in the last two lines, it

is stated, without citation of folio, that appellee now "was not qualified for any employment that didn't involve a great deal of physical effort." This is erroneous, as the proof of appellee is not to this effect. The evidence is uncontradicted that the appellee had progressed through many menial physical labor jobs to jobs in which he was a salaried employee of a major corporation receiving substantial pay with commensurate responsibility. This is shown by the various responsible supervisory positions held, and while certainly they were not desk jobs, neither were they menial labor jobs. Appellee fails in his proof on this point because it is clear that he is able to read, write, handle normal reports of work completed, men employed, accidents happening, holds a drivers license and can drive a car, and can instruct men on how to use heavy construction equipment. The proof is uncontradicted that appellee made no effort to obtain jobs along this line of experience, the only job he sought to hold after the September 1963 event being that of sweeping.

On Page 6 of appellee's statement of facts he lists the disability which he claims prevent him from working. These are simply unable to be on his feet except for short period, unable to sit for long times, nervous and shakey. Appellant would somewhat subscribe to this list, in that the cervical operation eliminated any headaches, left only a very minor disability in the neck and shoulder in the way of discomfort, and left a very minor lack of feeling in a little bit of the left forearm and three of the left hand fingers. This means that the disability he presently complains of is primarily related to and occurred only after the event of February 21, 1964, when he stepped out of bed and felt a sudden pain is his lower extremities. Except for the shortness

of breath, hearing loss and back fusion, it is uncontradicted that these items arising at the February incident did not exist prior to the February incident. The present disabilities, then being completely unrelated to the cervical accident, and relating wholly to the alleged accident of stepping out of bed, appellee by claiming only these disabilities in effect admits a substantial new cause has entered and occurred at a period outside of the insurance policy.

Appellee's dilemma is made clear in relation to these facts on Page 24 and 25 of his brief, where an attempt to relate the necessary diagnostic myelographic study to the subsequent disability is set forth, alleging that the effects of the opaque dye is the point tying the two together. This must fail, for appellant has already cited in its brief in detail that both appellee's expert Dr. Shaw and all of the doctors testifying for appellant agree that arachnoiditis cannot be determined to be the cause of the lower extremities problem. Appellee is committed to this position by his own expert Dr. Shaw, and certainly the clear evidence provided by those who were an expert in the field is to that effect. Dr. John Raaf is shown by the testimony (TR 338-340) to be one of the outstanding neuro surgeons of the West Coast, and Dr. Edward Keifer, in addition to being the actual surgeon in the case, is shown to be a highly qualified neuro surgeon belonging to nationally known and highly selective organizations in his field (TR 289-90). Appellee does not answer the points raised in the appellant's brief that in fact he is bound by the statement of his own medical expert, Dr. Manley Shaw, a well qualified orthopedic surgeon, that very likely the pain that arose on stepping out of bed was from irritation to nerve root

probably caused by scar formation arising probably from the previous fusion operation. Appellant's brief 26-27. Recalling that all of the doctors agree that any inflammation which could have occurred in the spine and resulted in scar tissue, which might have caused the disabilities in the lower extremities, would have required a considerable period of time, the fact that this pain arose instantaneously on stepping out of bed, and within a few hours after the myelogram, clearly points to the reason the doctors would not relate it to the myelogram. Where the medical records show no increase in the level of the temperature, pulse or respiration indicating any inflammation, and the symptoms alleged to have occurred, and claimed to exist to the present time, occurred within a few hours of the myelogram, it is clear that some other mechanism was involved.

Thus appellee has no facts by which to trace causation from the September accident through to the February event. The dye cannot relate the myelogram to the February disability that is now claimed, and a violent result of stepping out of bed is so highly unusual, unexpected, and tragically out of proportion to the event that caused it as to be an accident within its own effectuating circumstances.

Appellee says that cases cited by appellant of unusual circumstances unrelated to the original injury which broke the causation relationship do not apply here. Yet, this is precisely the situation involved. Appelle was the only one present when he got out of bed and has made no explanation of how the sudden pain arose other than he just stepped down. That something happened in the manner this occurred very likely relating to the previous fusion operation and other injuries to him, is no different than if the ceiling fell on

him at that point. The cited cases show this was just as unrelated; it was just as unusual, unexpected, and considerably out of proportion to what he was doing in stepping out of bed as if he were just lying there when it happened, and it did not result directly and independently of all other causes from the original accident of September, 1963.

Other minor misstatements of fact are as follows: On Page 10 of the brief appellee states the proof of loss form was dated September 9, 1964, when in fact it was dated September 8. Further, for appellee to claim he fully complied with the claim provisions of the policy is to evade the facts. As is fully set forth at Page 78 of appellant's brief, there is a failure to prove within the terms of the policy that following the accident a full 365 days had elapsed, after which event he was fully disabled and after which event the loss occurred and a claim could be filed. At least there was an issue of fact which should not have been taken from the jury, which instruction number 11 did. Secondly, it avoids the issue of whether the loss of full and total disability followed the September, or the February, accident. The point raised by appellant was simply that the instruction is erroneous as a jury issue exists. Appellee has not answered this.

On Page 32 of appellee's brief, it is stated the various, previous inconsistent statements that appeared in the pleadings of appellee could not be the basis for questions to appellee for impeaching him, and therefore, the exhibits were "obviously inadmissible." The point referred to is Specification 18 (b) and (c), and the argument thereon, appellant's brief Pages 85-86. Instead of misstating the facts that they were obviously inadmissible, appellee should have distinguished, if he

could, the law cited for the right to impeach a witness by his previous statements appearing in the pleadings he had filed. It stands as error for the Court to have prevented appellant thus impeaching appellee.

Appellee infers on Page 35 of his brief, as to appellant's claim of prejudicial actions of the court, that the appellant failed to take reasonable efforts to object and have the court change his proceedings so as not to make them prejudicial. Certainly the principal cited is correct, but appellee fails in any particular to apply it to the case. He would do well to explain how, as to the dispute over the admissibility of Exhibit 20, the medical report, appellant's counsel could have done anything more. The argument between counsel and the court, in which the court continues his exposition of appellee's position, takes some two pages of the transcript and all objection possible was made. Appellee is absolutely in error when he states at the bottom of Page 35 of his brief that there was no criticism of counsel by the court. A close reading of the portion relating to Exhibit 20 clearly shows that the court was being very specifically critical of the objection raised by counsel and of counsel's persistence in objecting. As even cited by the appellee at Page 30 of his brief, when the court was inquiring about calling the proper officer to identify the exhibit, he used the word "we" as if he were plaintiff's counsel who is being forced to call a proper officer. In the course of this appellant's counsel even had to interrupt the court, who was carrying on the direct examination for the appellee, for the privilege of asking a question in aid of an objection to the question the court was asking. Now it is obvious that after the discussion that appears in the transcript from TR 244 through TR 246 that this was not a mere in-

advertence by the trial court, but that he was well aware of what he was doing. It is interesting to note that appellee does not challenge the statement of appellant at brief, Page 95, that the court's inflexion in making its final rulings in relation to Exhibit 20 were not without considerable emphasis not favorable to appellant.

Certainly appellee is in error at Page 36 of his brief in stating that appellant admits there was no "specific instance" of remarks or conduct prejudicial to appellant. What has been said above clearly shows one very important instance. Further, the specific items set forth in the specification of errors show other instances claimed. While there is, of course, an accumulation of the evidence of the court's feeling in the case, nevertheless, appellant has not admitted that there were not specific instances that were very prejudicial.

II. FURTHER LEGAL ARGUMENT

Appellee raises a number of points that need to be clarified, as well as certain additional cases cited on two major points.

By two devices appellee seeks to avoid the problem presented that the cervical spine injury, and any disability therefrom, was substantially corrected by the cervical spine's surgery. First, he seeks to refer only to the alleged ability of the appellee to do his work prior to the September 1963 accident and the alleged inability to do the work after February 1964 as evidence that the disability arose wholly from the September accident. This is an error in logic, because it ignores the wording of the insurance policy under which claim is made. The injury alleged, not the inability to do the work, must result directly and independently from all

other causes from ". . . injuries caused by accident . . ." Whether the particular injury is the severance of a leg, or a sore neck, it is the item which must be related to the accident, not the loss which may result. Appellee has failed to sustain the proof required that the pre-existing disabilities and infirmaties are not to a large extent the cause of the loss, not the accident.

The second mistake of logic by the appellee is his apparent position that regardless of what happens to an injured person following an insured accident, it is related to the original accident. This in effect requires that you ignore the very clear wording of the insurance policy, that the injuries must be caused directly and independently of other causes by the accident and not from an excluded cause. The applicable law is cited in appellant's brief in the argument section on "The Policy of Accident Insurance" and "Is Appellee's Claim Within the Policy." Appellee seeks to ignore the very material lack of causual relationship of the injury which apparently occurred on stepping out of bed in February. The alleged severe injury to the lower extremities on the minor act of stepping out of bed is a new cause — a new accident — not related by the evidence to the insured September accident.

This brings us to the third error in the appellee's logic, the burden of proof as to the excluded causes under the policy. Appellant treats this commencing at Page 61 of its brief, and appellee notes it under "miscellaneous issues" at Page 37 of his brief. Apellee is in error in claiming that the burden is upon appellant as to proving that the causes of the present condition of appellee falls within the excluded items of the policy. Appellant had cited the 1965 case of Idaho Supreme Court, *Evans vs. Continental Life and Accident Co.,*

supra. This case is in point as to the type of policy involved and the exclusion which included substantially identical terms to that before the court. Appellee cites the *O'Neil vs. New York Life Insurance* case, supra, in Idaho Supreme Court case of 1944.

Thus, the case relied on by appellee is not the law in Idaho as to the particular policy before the court. The recent *Evans* case, because of the extreme care in its writing and the very careful extensive citations given, shows what the Supreme Court of Idaho has specifically held in this situation and clearly shown the applicable law, disregarding any possible application of the older O'Neil case. The O'Neil case may also be distinguished by the fact that it was an accidental death policy with double indemnity provisions and the issue involved was a willfully committed assault or felony. There is a distinction between such defenses in double indemnity cases as suicide or willful assault with the exclusions of typical accident policy. Therefore, the reliance by appellee on *O'Neil* cases is inappropriate.

The same is true of the case of *New York Life Insurance vs. Wilson*, supra, cited by indirection through the ALR annotation noted on appellee's brief Page 38. This is a Circuit Court of Appeals case of 1949, and does not take into consideration the 1965 definitive holding of the Supreme Court of Idaho in the *Evans* case. It can also be distinguished as to the burden of proof question on the fact that it involved a life insurance policy with a double indemnity clause for accidental death resulting from external, violent and accidental means. As the Supreme Court of Idaho noted in the recent *Evans* case, you cannot use comparisons between the very different types of policies because different burden of proof rules apply. Therefore, appellee's position

on Page 39 of his brief that appellant did not meet its burden to show that the disabilities resulting from the September 9 accident were within the exclusions of the policy is in error.

Appellee does not claim that he proved the pre-existing disabilities and the subsequent event of February were without the policy exclusions, as the law shows he would have to in order to recover. All doctors agreed the pre-existing disabilities contributed to the present state of appellee. Further, as the facts set forth in appellant's brief show, the doctors were practically unanimous that the myleogram could not be determined to be the cause of the disabilities that allegedly arose when the appellee stepped out of bed in February 1964. Some thought the pain on stepping out of bed was due to the pre-existing disability of the fusion, and others said that because there was an absence of any significant neurological findings it was wholly conjectural what the actual cause may have been.

Importantly, appellee does not contest that the various results of previous injuries were not diseases or bodily infirmities, but only contends that because appellee could do his work they were immaterial. This is particularly important when it is recalled that Dr. Franklin David, as a witness for appellee diagnosed a 40% pulmonary deficiency, emphysema, chronic bronchitis, and pulmonary fibrosis existing in the appellee. These, of course could not have been caused by the cervical injury, must have developed over a considerable period of time, and specifically after the May 1963 accident had reduced his final capacity to walk more than two or three blocks without shortness of breath. Similarly, the cramping or charley horses in the lower extremities caused by walking a few blocks in the absence

of neurological changes was pretty well determined to be intermittent claudication, spasms of the muscles caused by lack of blood supply. Again there is a failure on the behalf of appellee to tie-in this fact by any chain of causation to the cervical injury of September 1963, either directly or through the event of February, 1964. This is primarily true for the reason that appellee is bound by the testimony of his orthopedic surgeon specialist, Dr. Manley Shaw, that you cannot determine what caused his lower leg disability. Appellant's brief Page 27. Even appellee's witness, Dr. Burton, admitted that without a biopsy of the tissues of the spinal cord he could not tell for certain what the cause might be.

Appellee's brief raise another question, whether the wording of the exclusions in the policy are to be differently interpreted because they do not use the words "directly or indirectly, wholly or in part." It is to be recalled that the exclusion of the policy is a direct one, saying it does not "cover loss caused by or resulting from any one or more of the following." Appellee argues this point at Pages 12-14 of its brief. Appellant would add to the discussion set forth in its brief Page 56-60, the following additional authority.

We must first note the general rule that the construction of an insurance policy most strongly in favor of the insured and against the insurer has no application unless it is first determined there is an ambiguity in the policy. This rule relating to ambiguities has no application to interpretation of clear meaning of policy. *Bergholm vs. Peoria Life Insurance*, 284 US 489, 52 Sup. Ct. 230, 231, 76 L. Ed. 416. As appellee has pointed out no ambiguity in the policy, rule of construction claim is not applicable.

This leaves only the question of the clear meaning

of the policy, which appellee says as to the exclusionary provisions is some way effected because it does not include the additional words "wholly or in part, or directly or indirectly." Thus appellee would interpret the two basic provisions of the policy, that requiring that the injury result directly and independently of all other causes from bodily injuries, and the exclusion that the policy does not insure a loss resulting from illness or bodily infirmity, to mean that the exculsionary provision applies only if the loss is in whole caused by illness or bodily infirmity. This interpretation would in effect read the exclusionary clause out of the policy.

Appellant's specific objection to the instruction given was that it only covered the first test, directly or independently of all other causes, and did not include any instruction on the exclusion provisions. Appellee argues at Page 14 of his brief that it would have confused the jury to include the exclusionary provisions, and it was permissible for the court to reduce the contract to its simple and basic point. This was clearly erroneous.

First, the exclusionary clause is a special clause limiting the general clause and under the rules of construction any conflict between general and special clauses gives preference to the special clause. The cases generally hold that the basic provision of the present policy, that injury must result directly and independently of other causes from the accident, is a sole cause clause, and that the clause that the policy does not insure against a certain type of loss is an exclusionary clause. As pointed out in appellant's brief, Page 55-58, including cases therein which have not been distinguished or attacked by the appellee, the addition of such an exclusionary clause definitely creates a dif-

ferent type of contract. In addition to the requirement that the injury be caused by an accident as the "sole cause," which some courts have held to require only proximate cause, there is the additional exclusion that the same proximate cause cannot include the specifically excluded items working in conjuction with the accident. Appellant ignores the fact that the Idaho Court has recognized this in two cases, *Evans vs. Continental Life and Accident*, supra, and *Rauert vs. Loyalty Protective Insurance Co.*, supra.

Appellant thoroughly discussed the *Evans* case under burden of proof, appellant's brief, Pages 61-62, showing therein a specific discussion of the case cited by the Idaho Court, *Metropolitan Life Insurance Company vs. Rosier*, supra. The cases therein cited show whether the words "wholly or in part, directly or indirectly," are used has not been a distinguishing factor in the application of the exclusionary clause. Because under accident insurance policies, as distinct from life insurance policy, the burden is on the beneficiary to prove a certain type of accident within the limited coverage, as opposed to death from whatever cause, such beneficiary must show he is within the term of the policy and also outside the specific exclusions. If that is the burden of proof, the obvious meaning must be given to the exclusionary policy provisions. This was recognized by the Ninth Circuit Court of Appeals in *U.S. Fidelity and Guaranty Co. vs. Blum*, 270 F. 946, (1921) where the decision refused to recognize a possible concurring cause of the injury under a policy which only had the sole cause clause in it, without the exclusionary clause as to disease or bodily infirmity. The court stated:

"Referring again to the suggestion that death may

have been result of concurring causes, that is, of disease and accident, and therefore not within the terms of the policy, because of the language covering death, 'affected directly and independently of all other causes under such circumstances the inquiry simply resolves itself into one of approximate cause . . .

"Our attention has not been called to any clause in the policy which precludes recovery on the grounds that disease has operated concurrently with 'accidental means' to produce injury or death. This court is not required to search beyond the active, efficient procuring cause . . ." 270 F. at 957.

In both the *Rauert* and the *Evans* case the Idaho Court specifically recognized, by its holding, that the additional exclusionary clause had to be avoided in order that the proximate cause from injury received from accident would allow recovery. An additional example is the case of *Kingsland vs. Metropolitan Life Insurance*, 97 Mont. 558, 37 P. 2d 335, where the case distinguishes the former holding of that court that a mere frail general condition or a tendancy to disease cannot cooperate with an accidental cause to avoid recovery under the sole cause theory, but stating that the addition of the exclusionary clause results in the sole cause clause meaning that any contribution by the pre-existing disease is sufficient to avoid recovery unless the accident in and of itself was sufficient to cause the loss.

In the present case the fact that the exclusionary clause did not use the words "in whole or in part, directly or indirectly" makes no difference. In the first place they are included in the words of the original liability clause, that the loss must result "directly and

independently of all other causes" from injuries caused by accidents, as the loss could not be so direct and independent if it was caused by the excluded items. Secondly, where appellee's orthopedic surgeon expert, Dr. Shaw, specifically stated that the injury to the cervical spine would not have totally disabled the appellee except in conjuction with all of the other items that occurred to him, both before and after the September accident, if total disability exist today it has to be the result of the concurring accident and other conditions. To wit, the other items are a major cause as opposed to a mere minor relationship.

Appellant's witnesses likewise agreed with Dr. Shaw, and appellee is bound by his own expert witness. Thus, in a real sense, if total disability does exist, it is caused by bodily infirmity and pre-existing disease, for it would not exist merely because of the September accident. Certainly appellee is in error to argue that only if the pre-existing infirmity or disease is the entire cause of the loss where an accident is involved would the policy exclusion be effective, such argument containing its own answer.

Appellant's position is simply that the accident without the concurring major pre-existing disabilities would not have resulted in the alleged existing total disability, and that the fact of such a major concurring additional item with the accident clearly excludes it from the coverage of the policy. The jury instruction given by the court leaving out any direction as to the meaning of the exclusionary clause is error, regardless of what the definition of that clause should have been. Without some instruction on this portion of the policy, the jury would not have had the correct case submitted to it.

We would conclude this question as to the nature of the wording of the exclusionary clause of the policy by again citing *Russell vs. Glens Falls Indemnity Company*, supra, that is quoted at Page 57 of appellant's brief, that there is no difference between the inclusion in the exclusionary clause of the words "wholly or in part, directly or indirectly" or the statement without such exact words in creating a contract different from the sole cause contract. Where there is such an exclusion as to bodily infirmity or disease the general clause of the accident policy has to be given additional meaning. The court specifically held in the *Russell* case that it was errored to instruct the jury as to the directly and independently of other causes clause and to omit any instruction on the exclusionary bodily infirmity clause.

Another area that the appellee's brief does not clarify is the point made by appellant that in affect there were two accidents from two separate causes. On Page 24 of his brief he cites the Idaho *Rauert* case to the effect that loss occurring after medical treatment following an accident is within the policy. This case has already been carefully outlined in appellant's brief at Pages 58, 59. The case stands for the principal that where a hernia occurred as a result of an accident, and as a result of the operation to correct it strangulation of the bowel took place due to a pre-existing adhesions from an earlier hernia operation, recovery was allowed because the policy merely excluded loss from injuries if due to disease. The exclusion was not applicable as the particular disability was an "infirmity." The Idaho Court would have denied recovery if the policy contained the additional words of exclusion "from disease." The case, therefore, is con-

trary to appellee's position.

On the other hand, appellee does not distinguish the case of *Wilson vs. New York Life Insurance Company*, supra, cited in appellant's brief in detail at Page 69 under the issue of a second accident. In fact, the analogy is this. The *Wilson* case is a holding that the unusual results of treatment, coughing after an operation, was an accident in itself and the sole proximate cause of the loss. The *Rauert* case is one of disease preceeding an accident in the treatment. In both cases the Idaho law states that the second event is a separate, distinct event which is the accident and the sole proximate cause of the loss. Similarly under Idaho law the event that occurred on appellee stepping out of bed in February had such unusual and unexpected results from such a minor cause as to clearly constitute an accident in itself. In fact, even if the appellee had by the facts been able to show that the event of February was due to irritation created by the dye in the myelogram, the same would have been true. This is so because it is highly unexpected, unusual, and the result was highly exaggerated compared to the cause for the myelographic dye to have the effect alleged. This comes clearly within the *Wilson* and *Rauert* cases as a separate accident occurring at or after treatment the time of the treatment even though an earlier accident had occurred. Because all of the expert witnesses agreed that the reaction, if it came from the myelogram, was highly unexpected and unusual, the treatment becomes a separate and distinct accident in itself; as such it is a cause of the disability alleged which cannot be directly and independently from all other causes from the accident of September 9.

Thus, this court stated in the *Wilson* case that the

coughing which occurred after the operation, and with no apparent relation to the operation itself, causing the thrombosis to break loose, was a

> ". . . untoward mishap in this instance as the inducing and sole proximate cause of the loss." 178 F. 2d at 537

Similarly, what occurred in the lower extremities, and which really is the only basis of the alleged total disability, is similar, unexpected and unexplained mishap unrelated to what occurred, and is inducing and sole proximate cause of the loss wholly apart from the injury of September 9, or the diagnostic myelogram.

Finally, answering the question of whether the appellee is totally disabled within the definitions of the policy, appellee is in error in his position that he only needed to prove he could not do heavy manual construction work in order to recover. It is clear that the policy does not pay for a loss based on disability where, even though the injured person cannot do exactly what he was doing before, he can enter into useful, economically valuable work. For example, under a slightly different policy a young girl trained from the age of four to be a ballerina, and who at the age of eighteen while working at excellent pay in the road show of "My Fair Lady" suffered a knee injury during a performance. Subsequent surgery resulted in her inability to dance. She then took a position as a model and a receptionist, and later as a sales lady, at a very much reduced ability to earn. Recovery under an accident policy for total disability within the training and experience of the injured person was denied, the New York Court stating that the fact the insured was only qualified for one occupation, from which she was ad-

mittedly disabled, did not meet the requirements of total disability, where she was at least qualified ". . . to engage in any of the common forms of employment available to girls of similar age and background."

> "It is sufficient to bar recovery hereunder that the insured can qualify for other employment which, in a clear sense, is remunerative. (Cases cited)" *Tschida vs. Continental Casualty Company*, 246 N.Y. Sup. 2d 72 at 76.

The evidence is absolutely lacking to show that Appellee could not so engage in such occupations that an older man of his experience with some disabilities normally could carry on.

There is little conflict in the medical evidence as to Appellee's condition, such as exists being primarily the statements of Dr. Burton as opposed to all of the other physicians. We would first note that Dr. Burton, while a licensed physician, does not hold the various national medical association position and honor position of a number of the other doctors who testified as experts.

Secondly, we would point out that Dr. Manley Shaw, who is an expert orthopedic surgeon, in testifying for the appellee agrees primarily with the appellant's physicians. We would, therefore, call the court's attention to the general position as to conflicting medical testimony that

> "We, as laymen, have no way of determining which theory of the physicians is correct, but whereas the law places the burden of proof on plaintiff and requires that he make out his case by a preponderance of the evidence, we feel we can not do otherwise than to agree with the District Judge . . .

> ". . . true, mere numerical numbers of experts are not sufficient for a determination of a decision . . .
>
> "There is, therefore, only the statement of the plaintiff himself, collaborated to some extent by Dr. Fenno, as against the testimony Drs. Landrey, Edrington, Stone and Benville, with the result that there is an overwhelming preponderance of medical testimony unfavorable to the contention of plaintiff. The plaintiff in a compensation case must make his case reasonably certain. (Cases cited)" *McNutt vs. Hughes Construction Company*, 176 So. 2d 315 (Ct. App. La. 1963).

This is substantially the case here. Only Dr. Burton, who made a completely erroneous diagnosis of what the cervical injury was, and who is not an expert in either orthopedics surgery or neuro surgery, is the only doctor who to any extent supports appellee's claim as to the cause of his present disability. He is the only doctor who feels he would have been totally disabled by the September 9 accident in disregarding any other pre-existing or later happening events. All of the other doctors, including appellee's own medical expert, disagree. It is submitted that this matter should not have been sent to the jury on the medical point alone in that there was no preponderance of the evidence of sufficient certainty upon which the jury could have acted favorable to the appellee.It is also submitted that the legal interpretation of the policy by the court below, implicite in his rulings and instructions, was erroneous. These items, together with the specifications of error, form a basis of substantial prejudice to appellant.

Wherefore the appellant respectfully prays that this

matter be reversed by this Honorable Court.

Respectfully submitted,

RICHARDS, HAGA & EBERLE

By______________________________

Attorney for Plaintiff
711½ Bannock Street
Boise, Idaho

No. 20,827

IN THE

United States Court of Appeals
For the Ninth Circuit

K. B. & J. YOUNG'S SUPER MARKETS, INC., *Petitioner*

vs.

NATIONAL LABOR RELATIONS BOARD, *Respondent*

BRIEF FOR PETITIONER

FRAME & COURTNEY,
330 North Fifth Street,
Coalinga, California,
Attorneys for Petitioner.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO

Subject Index

Page

Jurisdictional statement 1

Statement of the case 1

Statutes involved 4

Specification of errors relied on 5

Questions presented 6

Summary of argument 7

Argument 8

I. Where a small, non-unionized firm purchases part of the operations of a large, unionized firm, and the purchaser does not employ any of the employees of the seller, the purchaser is not a successor within the meaning of the Act 8

II. It is not an unfair labor practice for a purchaser of a unionized business to request the seller of the business to terminate the seller's employees upon the sale so that the purchaser will be free to hire its own employees 12

III. There is no basis for the NLRB order that petitioner reinstate Hob Nob's employees 16

IV. There is a lack of substantial evidence to support the findings of individual discrimination and the finding of the single employer 20

Conclusion 26

Table of Authorities Cited

Cases

Page

American Furniture Co., 116 NLRB 1496 (1956) 2
Anglo Canadian Shipping Co., Ltd. v. Federal Maritime Comm., 310 F.2d 606 (C.A. 9, 1962) 1

Bedford-Nugent Corp., 151 NLRB No. 26 (1965) 1

C. A. Batson Co., 108 NLRB 1332 (1954) 2
Chemrock Corporation, 151 NLRB No. 111 (1965) 1
Clark Thread Co., 79 NLRB 542 (1948) 2
Cruse Motors, 105 NLRB 242 (1953) ....

Hemisphere Progressive Corp., 154 NLRB No. 65 (1965) ... 1
Humble Oil & Refining Co., 153 NLRB No. 111 (1965) 1

Jays Foods, Inc., 292 F.2d 317 (C.A. 7, 1961) 1
Jefferson Co., 105 NLRB 202 (1953) 2

M. Lowenstein & Sons, Inc., 150 NLRB No. 66 (1964) 2
Malcolm Konner Chevrolet Co., 141 NLRB No. 43 (1963) .. 2
McGuire v. Humble Oil & Refining Co., ... F.2d .... (C.A. 2, Jan. 31, 1966), 53 CCH Labor Cases § 11,026 .... 11, 1
William E. McClain, 158 NLRB No. 18 (1966) 1

N.L.R.B. v. Alamo White Truck Service, 273 F.2d 238 (C.A. 5, 1959) 1
N.L.R.B. v. Coca Cola Bottling Co., 333 F.2d 181, 56 LRRM 2562 (C.A. 7, 1964) 2
N.L.R.B. v. Covington Motor Co., 344 F.2d 136, 58 LRRM 2811 (C.A. 4, 1965) 2
N.L.R.B. v. Deerfield Screw Products Co., 329 F.2d 558 (C.A. 6, 1964) 2
N.L.R.B. v. Flomatic, 347 F.2d 74 (C.A. 2, 1965) 12, 1
N.L.R.B. v. New England Tank Industries, 302 F.2d 273 (C.A. 1, 1962) 14, 1
N.L.R.B. v. Textile Machine Works, 214 F.2d 929 (C.A. 3, 1954) 1
Neuhoff Bros., 151 NLRB No. 103 (1965) 1

Paramount Paper Products, 154 NLRB No. 89 (1965) 1
Park Plaza Amusement Co., 124 NLRB 428 (1959) 2
Piasecki Aircraft Corporation v. N.L.R.B., 280 F. 575 (C.A. 3, 1960) 15, 16, 1

Randolph Rubber Co., 152 NLRB No. 46 (1965) 1

Pages

Riggs Distler & Co., Inc. v. N.L.R.B., 327 F.2d 575, 55 LRRM 2145 (C.A. 4, 1963) 20
Carl Rochet d.b.a. Renton News Record, 136 NLRB 1294 (1962) 26
San Francisco Metal Products, 155 NLRB No. 27 (1965) .. 11
Sinko Mfg. & Tool Co., 154 NLRB No. 117 (1965) 11
Steelworkers v. Reliance Universal, 335 F.2d 891 (C.A. 3, 1964) 9
Textile Workers v. Darlington Mfg. Co., 380 U.S. 263 (1965) 14
Triumph Sales, Inc., 154 NLRB No. 71 (1965) 11
Union Texas Petroleum, ... F.2d ..., 53 LC, Para. 11,259 (C.A.D.C., May 24, 1966), affirming 153 NLRB No. 71 (1965) 15
Wackenhut Corp. v. Plant Guard Workers, 332 F.2d 954 (C.A. 9, 1964) 9
West Suburban Transit Lines, 157 NLRB No. 77 11
John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 84 S.Ct. 909 (1964) 9

Statutes

National Labor Relations Act:
Section 7 (29 U.S.C. Sec. 157) 4, 10, 12
Section 8(a) (29 U.S.C. Sec. 158(a)) 4
Section 8(a)(1) 2, 3, 6, 15
Section 8(a)(3) 2, 3, 6, 15, 20
Section 8(a)(5) 2, 3, 6
Section 10(e) (29 U.S.C. Sec. 160(e), et seq.) 1
Section 10(f) 1

29 U.S.C. Sections 151, et seq. (National Labor Relations Act) 2

Regulations

29 Code of Federal Regulations:
Section 101.11 13
Section 101.12 13
Section 102.45 13
Section 102.48 13

Texts

Webster's Twentieth Century Dictionary (1955) 17

No. 20,827

IN THE

United States Court of Appeals

For the Ninth Circuit

K. B. & J. YOUNG'S SUPER MARKETS, INC., *Petitioner*

vs.

NATIONAL LABOR RELATIONS BOARD, *Respondent*

BRIEF FOR PETITIONER

JURISDICTIONAL STATEMENT

This is a petition by an employer to review and set aside a Decision and Order of the National Labor Relations Board. (R. 52, 54.) The National Labor Relations Board (hereinafter, "NLRB") has filed a cross petition for enforcement of its order. (R. 57.) Jurisdiction of this Court rests upon Sections 10(e) and 10(f) of the National Labor Relations Act (29 U.S.C. § 160(e), et seq.).

STATEMENT OF THE CASE

In April, 1964, William Young and Charles John Young, who are brothers, purchased from Hob Nob Stores, Inc., d/b/a Kelley's Markets, three retail

supermarkets in Bakersfield, California. Hob Nob operated thirty other supermarkets and was part of a large corporate complex. (Tr. 243-244.) The Youngs organized a corporation, petitioner herein, to operate the stores. (Tr. 283.) At the request of the Youngs, Hob Nob terminated its employees. (Tr. 247.) Hob Nob closed the stores. (Tr. 249.) The stores remained closed for a day and reopened the following day under the Youngs' management. The Youngs did not hire any former Hob Nob employees. The Youngs hired one former Hob Nob grocery department supervisor, but none of the Hob Nob meat department supervisors. (Tr. 355.)

Hob Nob had a collective bargaining agreement with Butchers Union Local 193 at the time of the sale. The agreement covered the three stores purchased by the Youngs and was effective until January, 1965. (G.C. Exh. No. 2.)

After the sale Local 193 requested petitioner to honor the agreement. Petitioner refused to do so.

A consolidated complaint (R. 10) filed January 27, 1965, charged that petitioner caused Hob Nob to discharge its employees, that petitioner failed "to recall" the employees, that petitioner was the "successor" to Hob Nob within the meaning of the National Labor Relations Act (29 U.S.C. § 151, et. seq.; hereinafter, "the Act"), that petitioner failed to bargain with Local 193 after purchasing the three stores, and that by such acts, petitioner violated Sections 8(a)(1), 8(a)(3) and 8(a)(5) of the Act. The complaint also charged petitioner with three incidents of individual

discrimination in violation of Sections 8(a)(1) and 8(a)(3) of the Act.

An amendment to the consolidated complaint (R. 19) alleged that petitioner and Jack Young's Supermarkets, another corporation operating a supermarket in Bakersfield, were a "single employer" within the meaning of the Act.

Petitioner denied all the material allegations of the consolidated complaint and the amendment to it. The matter went to hearing before an NLRB trial examiner in Bakersfield, on May 3 and 4, 1965.

The trial examiner found that petitioner caused Hob Nob (Kelley) to discharge its employees "in order to evade and escape its obligations as a successor to Kelley to recognize and bargain with the Union and to honor and apply its unexpired bargaining agreement." (R. 36, 37.) He further found that petitioner refused to bargain in good faith with Local 193, that petitioner discriminatorily refused to hire Norma Newton, an ex-Hob Nob employee, and that petitioner discriminatorily discharged two of its employees, Jack Baldwin and Imogene Brewton. He concluded that petitioner had violated Sections 8(a)(1), 8 (a)(3) and 8(a)(5) of the Act. (R. 39.) He also concluded that petitioner and Jack Young's Supermarkets were a single employer. (R. 35.) The trial examiner recommended that petitioner be ordered to offer immediate reinstatement to all of Hob Nob's former employees in the appropriate unit, that petitioner be ordered to offer reinstatement to Jack Baldwin and to Imogene Brewton, that petitioner be ordered to make whole

Hob Nob's former employees, and Baldwin and Brewton "for any loss of pay they may have suffered as a result of the discrimination against them", and that petitioner be ordered to bargain with Local 193 as the representative of its employees. (R. 40.)

In a brief order the NLRB adopted the recommendations of its trial examiner. (R. 52.)

This petition followed.

STATUTES INVOLVED

Section 7 of the National Labor Relations Act (29 U.S.C. § 157) provides:

> "Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8(a)(3)."

Section 8(a) of the Act (29 U.S.C. § 158(a)) provides that

> "it shall be an unfair labor practice for an employer—
>
> "(1) To interfere with, restrain, or coerce employees in the exercise of rights guaranteed in section 7;"
>
> * * * * *

"(3) By discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization. . . ."

*   *   *   *   *

"(5) To refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 9(a)."

SPECIFICATION OF ERRORS RELIED ON

1. The NLRB erred in failing to find whether petitioner was the successor of Hob Nob within the meaning of the Act.

2. If a finding may be implied that petitioner was the successor of Hob Nob within the meaning of the Act, the finding is in error.

3. The NLRB erred in finding that petitioner caused Hob Nob to discharge its employees in order to evade and escape petitioner's obligations as a successor to Hob Nob to recognize and bargain with Local 193 and to honor and apply its unexpired bargaining agreement.

4. The NLRB erred in finding and concluding that petitioner was legally obligated to recognize and bargain with Local 193 as the collective bargaining representative of petitioner's employees and that petitioner unlawfully refused to do so.

5. The NLRB erred in finding that petitioner discharged Imogene Brewton because of her Union and concerted activities.

6. The NLRB erred in finding that petitioner discharged Jack Baldwin because of his Union affiliation and activities.

7. The NLRB erred in finding that petitioner denied Norma Newton employment because of her refusal to withdraw from the Union, or otherwise.

8. The NLRB erred in finding that petitioner and Jack Young's Supermarkets constituted a single employer within the meaning of the Art.

9. The NLRB erred in finding and concluding that petitioner engaged in and/or is engaging in unfair labor practices within the meaning of Sections 8(a)(1), 8(a)(3) and 8(a)(5) of the Act.

10. The NLRB erred in ordering petitioner to take the action set forth in the Trial Examiner's Recommended Order (R. 40), there being no proper basis for the Order and the Order not being necessary to effectuate the policies of the Act.

11. The NLRB erred in fashioning remedies based on petitioner's refusal to hire the former Hob Nob employees. Petitioner was not charged with having refused to hire the Hob Nob employees and petitioner was thereby denied due process of law.

QUESTIONS PRESENTED

1. Where a small non-unionized firm purchases part of the operations of a larger unionized firm, and the purchaser does not employ any of the employees

of the seller, is the purchaser a successor within the meaning of the Act?

2. Is it an unfair labor practice for the purchaser of a unionized business to request the seller of the business to terminate the seller's employees upon the sale so that the purchaser will be free to hire its own employees?

3. Does it effectuate the policies of the Act to require the purchaser of a unionized business to offer "reinstatement" to the employees of the seller where the employees of the seller did not apply to the purchaser for employment and were not hired by it?

4. Is there substantial evidence to support the findings and conclusions of the NLRB that petitioner was guilty of acts of discrimination against Norma Newton, Jack Baldwin, and Imogene Brewton?

5. Is there substantial evidence to support the findings and conclusion of the NLRB that petitioner and Jack Young's Supermarkets were a single employer within the meaning of the Act?

SUMMARY OF ARGUMENT

Where a small, non-unionized firm purchases part of the operations of a large, unionized firm, and the purchaser does not employ any of the employees of the seller, the purchaser is not a successor within the meaning of the Act. The essential element is the employer-employee relationship. It is not an unfair labor practice for the purchaser of a unionized busi-

ness to request the seller of the business to terminate the seller's employees upon the sale so that the purchaser will be free to hire its own employees. The purchaser of a business is free to hire its own employees. If as is the case, petitioner was not a successor and was free to hire its own employees, and did so, the representative status of the union did not continue after the sale. There is no basis for a requirement that petitioner reinstate the employees of the seller unless the seller's employees applied to petitioner for employment and were refused because of their union affiliation or activity. The seller's employees did not apply. There is a lack of substantial evidence to support the findings and conclusions of the NLRB as to the alleged instances of individual discrimination and as to the single employer. Speculation, surmise, conjecture or innuendo are not evidence.

ARGUMENT

I. WHERE A SMALL, NON-UNIONIZED FIRM PURCHASES PART OF THE OPERATIONS OF A LARGE, UNIONIZED FIRM, AND THE PURCHASER DOES NOT EMPLOY ANY OF THE EMPLOYEES OF THE SELLER, THE PURCHASER IS NOT A SUCCESSOR WITHIN THE MEANING OF THE ACT.

It seems undisputed that Hob Nob was a large firm (Tr. 243-244), that its employees were unionized, that petitioner was (and is) a small firm (Tr. 95-96), that it was not unionized, and that it did not hire any of Hob Nob's employees (Tr. 356-358).

If petitioner was a successor within the meaning of the Act, it may have been obligated to bargain with

Local 193, the collective bargaining representative of the employees of Hob Nob, its predecessor. *Cruse Motors,* 105 N.L.R.B. 242, 247 (1953). Also, under recent decisions discussed *infra,* it may have been bound to arbitrate grievances arising under the Hob Nob-Local 193 collective bargaining agreement had Local 193 requested it to do so.

If petitioner was not a successor, it was not obligated in either respect.

In *John Wiley & Sons, Inc. v. Livingston,* 376 U.S. 543, 84 S.Ct. 909 (1964), a small unionized firm merged with a larger non-unionized one. There was a "wholesale transfer" of the smaller firm's employees to the larger firm's plant. The Supreme Court ruled that "the disappearance by merger" of an employer who had a collective bargaining agreement with a union did not "automatically terminate all rights of employees covered by the agreement, and . . . in appropriate circumstances . . . the successor employer may be required to arbitrate with the union under the agreement". (376 U.S. 543, at 548.) The Court stated that "we do not suggest any view on the questions surrounding a certified union's claim to continued representative status following a change in ownership". (376 U.S. 543, at 551.) In the present case, Local 193 was not certified. (Tr. 274-275.)

In two later decisions, *Wackenhut Corp. v. Plant Guard Workers,* 332 F.2d 954 (C.A. 9, 1964), and *Steelworkers v. Reliance Universal,* 335 F.2d 891 (C.A. 3, 1964), the *Wiley* doctrine was applied by Courts of Appeal to purchase, rather than merger,

situations. In both cases substantially all the employees of the seller became employees of the buyer.

We are dealing here with a question of representation, not contract application. The Trial Examiner did not recommend, and the NLRB did not order, that petitioner apply the Hob Nob-Local 193 collective bargaining agreement. Local 193 did not file exceptions to the Trial Examiner's Decision. The General Counsel's Cross-Petition for Enforcement (R. 57) does not seek modification of the NLRB order.

In any event, representation or contract application, a purchaser of a unionized business is not *ipso facto* a successor employer. The essential element is the employee-employer relationship. *N.L.R.B. v. Alamo White Truck Service,* 273 F.2d 238, 242 (C.A. 5, 1959). That is as it should be. Petitioner's employees never worked for Hob Nob. In matters of representation, they should be free to make their own choice. Section 7 of the Act so provides. (29 U.S.C. § 157.)

The trial examiner asked at the conclusion of the hearing: "Are you still a successor, although you have none of the employees of the predecessor?" (Tr. 410.) There is no precedent for an affirmative answer.

In a number of recent cases the NLRB has required a purchaser to bargain with the representative of the seller's employees. In all the cases the seller's employees became the buyer's employees. In most of the cases there was no change in supervision. *Chemrock Corporation,* 151 NLRB No. 111 (1965); *Randolph Rubber Co.,* 152 NLRB No. 46 (1965); *Hemisphere Progressive Corp.,* 154 NLRB No. 65 (1965); *Para-*

mount Paper Products, 154 NLRB No. 89 (1965); *Sinko Mfg. & Tool Co.,* 154 NLRB No. 117 (1965); *West Suburban Transit Lines,* 157 NLRB No. 77 (1966); and *William E. McClain,* 158 NLRB No. 18 (1966).

However, where the seller's employees did not become the buyer's employees, the result has been to the contrary. *Triumph Sales, Inc.,* 154 NLRB No. 71 (1965); *San Francisco Metal Products,* 155 NLRB No. 27 (1965).

In *Triumph Sales, Inc.,* supra, the Board stated as follows:

> "On the basis of the record as a whole, we are satisfied that the 'employing industry' is not essentially the same and therefore that Triumph is not a successor to Bristlo. Thus, of the 7 employees of Bristlo, only 3 were working for Triumph when Triumph began operations as licensee of White Front, and Triumph has hired 17 additional employees; Triumph's employees work under supervision different from that of Bristlo's employees; Bristlo operated 7 liquor departments while Triumph is operating 11 departments, including 3 new locations and a Bristlo department which had been closed; and Triumph has added a line of gourmet foods not previously handled by Bristlo."

In *McGuire v. Humble Oil & Refining Co.,* .... F.2d .... (C.A. 2, Jan. 31, 1966), 53 CCH Labor Cases § 11,026), a small unionized firm sold its assets to a larger unionized firm. Thirteen of the seller's twenty-four employees were hired by the buyer. The Second

Circuit holds that the buyer was not required to arbitrate a dispute arising under the bargaining contract the seller had with the union which represented the seller's employees. The NLRB ruled earlier that the union which represented the buyer's employees became the exclusive bargaining representative of the seller's former employees. *Humble Oil & Refining Co.,* 153 NLRB No. 111 (1965).

The *McGuire* Court does not decide whether it would have required arbitration if the buyer had been non-unionized. It states that "we think it better to avoid crossing that bridge until it is necessary to do so". (53 LC, p. 16,183.)

Petitioner now asks this Court to cross the bridge in a representation setting.

While crossing, petitioner asks this Court to have in mind that a bargaining order is strong medicine, that its potential effect on employees' Section 7 rights must not be overlooked, and that the Act protects the right of employees to join or refrain from joining a labor organization. *NLRB v. Flomatic,* 347 F.2d 74, 78 (C.A. 2, 1965).

II. IT IS NOT AN UNFAIR LABOR PRACTICE FOR A PURCHASER OF A UNIONIZED BUSINESS TO REQUEST THE SELLER OF THE BUSINESS TO TERMINATE THE SELLER'S EMPLOYEES UPON THE SALE SO THAT THE PURCHASER WILL BE FREE TO HIRE ITS OWN EMPLOYEES.

The NLRB failed to make a finding on successorship. In a footnote to its decision (R. 52) it states that "The Trial Examiner's recommendation that the

Respondent be ordered to bargain with the Union is based in part on his finding, with which we agree, that the Respondent is the successor to Kelley's Supermarkets". The Trial Examiner's finding was that "Respondent caused Kelley to discharge its employees in order to evade and escape its obligations as a successor to Kelley to recognize and bargain with the Union and to honor and apply its unexpired bargaining agreement". (R. 37.)

The NLRB must make detailed findings of fact and conclusions of law and give basic reasons for decision on all material issues raised. (29 C.F.R. 101.11, 101.12, 102.45, 102.48.) A finding that petitioner took action to "evade and escape its obligations as a successor" is not responsive to the controverted allegation in the Consolidated Complaint that petitioner "is and has been, since on or about April 21, 1964, the successor to Kelley's". (R. 10, Paragraph G.) The absence of required findings is fatal to the validity of an administrative decision regardless of whether there may be evidence to support proper findings. *Anglo Canadian Shipping Co., Ltd. v. Federal Maritime Comm.,* 310 F.2d 606, 617 (C.A. 9, 1962).

The Trial Examiner concluded that petitioner's causing Kelley to discharge its employees "in order to evade and escape its obligations as a successor" was "discrimination against Kelley employees violative of Section 8(a)(1) and (3) of the Act". (R. 37.) His conclusion presents the question whether the purchaser of a unionized business may request the seller to terminate its employees so that the purchaser will

be free to hire its own employees. The question must be answered in the affirmative.

For focus there is the uncontroverted testimony of Frank Johnson, president of Hob Nob (Tr. 246):

> "Trial Examiner: I take it, Mr. Johnson, it was a part of the understanding that you had with them when they bought the business, was it, that you would terminate your help. They would be present to hire whomever they pleased. Is that right or wrong?
>
> The Witness: That is right."

An employer has a right to consider objectively and independently the economic import of unionization of his shop and to manage his business accordingly. *N.L.R.B. v. New England Tank Industries,* 302 F.2d 273, 276 (C.A. 1, 1962); *Jays Foods, Inc.,* 292 F.2d 317, 320 (C.A. 7, 1961).

In *Textile Workers v. Darlington Mfg. Co.,* 380 U.S. 263 (1965), the Supreme Court holds that a proposition that a single businessman cannot choose to go out of business (for whatever reason) if he wants to would represent a startling innovation without support in either statute or judicial precedent. So would a proposition that a purchaser of a business must retain the employees of the seller.

Darlington recognizes that some employer decisions are so peculiarly matters of management prerogative that they may be made without violating the Act, no matter what the motivation, and that the Act does not compel one to become or remain an employee or an employer.

In *Piasecki Aircraft Corporation v. N.L.R.B.*, 280 F. 575 (C.A. 3, 1960), Piasecki (the buyer) requested Bellanca (the seller) to terminate its employees upon the sale so that Piasecki would be free to hire its own employees. Later the Bellanca employees vigorously applied to Piasecki for employment and were just as vigorously rebuffed. The application—failure to hire aspect of the case will be discussed *infra*. The point here is that the Union contended that the termination of employment of the Bellanca workers was by reason of Piasecki's insistence and therefore was an unfair labor practice in violation of Sections 8(a)(1) of 8(a)(3) of the Act. The NLRB rejected the union's contention. The rejection is not disturbed by the Court. (280 F. 575, 589-590.)

In *Union Texas Petroleum*, ...F.2d ...., 53 LC paragraph 11,259 (C.A.D.C., May 24, 1966), affirming 153 NLRB No. 71 (1965), a non-unionized buyer who requested a unionized seller to discharge its employees and shut down its plant upon the sale did not violate Sections 8(a)(1) and 8(a)(3) of the Act. None of the seller's union employees were subsequently hired by the buyer.

It is submitted that a purchaser, for whatever reasons, may elect to hire a new work force. One of the reasons may be a desire to avoid unionization. There is no requirement in the Act that an employer like unions.

III. THERE IS NO BASIS FOR THE NLRB ORDER THAT PETITIONER REINSTATE HOB NOB'S EMPLOYEES.

The Trial Examiner recommended and the NLRB has ordered that petitioner offer reinstatement to all the former Hob Nob employees and that petitioner make them whole for any loss of pay suffered by reason of their discharge by Hob Nob. (R. 40, 52.) In the footnote to its decision, the NLRB states this would follow even if petitioner is not a successor, relying on *Piasecki Aircraft Corporation v. NLRB,* supra. *Piasecki* involves a discriminatory refusal to hire.

In *Piasecki* the Bellanca employees vigorously applied to Piasecki for employment. The evidence showed that Piasecki originally planned to hire all of Bellanca's employees in the unit, that the union representing Bellanca's employees advised Piasecki that Bellanca employees were available for employment (280 F.2d 575, at 579), that the union submitted written employment applications to Piasecki for 135 out of 139 employees in the unit (581), that when the applicants appeared at a hotel designated by Piasecki as the place for employment interviews, the front door was kept locked so that they could not enter (582), that all the applicants appeared at the plant on the first day of operation by Piasecki and offered themselves for employment, but found the door locked (582), and that the union secured newly signed authorization cards for 138 of the 139 employees in the unit (586).

The present case is quite different.

There is no allegation in the Consolidated Complaint (R. 10) except as to Norma Newton, that petitioner unlawfully refused to hire former Hob Nob employees who applied to it for employment. The allegation is that petitioner "since April 20, 1964, has failed and refused and has continued to fail and refuse, to recall said employees." (R. 10, paragraph 18.) "Recall" is defined in *Webster's Twentieth Century Dictionary* (1955) as meaning "to call back" and in this setting is synonymous with reinstatement.

The concept of a discriminatory refusal to hire is a different concept from a discriminatory discharge and refusal to reinstate. *NLRB v. Textile Machine Works,* 214 F.2d 929, 932 (C.A. 3, 1954); *Piasecki Aircraft Corp. v. NLRB,* supra, at 590-591.

It is improper to require petitioner to take affirmative action on the basis of having committed an unfair labor practice (discriminatory refusal to hire) not complained of. Cf. *Neuhoff Bros.,* 151 NLRB No. 103 (1965).

Further, petitioner can not be guilty of unlawful practices in refusing employees something which they had not in fact asked for. *NLRB v. Textile Machine Works,* supra, at 933. This leads to the question whether the former Hob Nob employees in fact asked petitioner for employment, or in the alternative whether there was conduct by petitioner such as the *Piasecki* locked doors which prevented them from doing so.

The record shows that although Hob Nob's employees were instructed to file applications for employment by petitioner if they desired to work for petitioner (Tr. 204), none of them except Forbes Barnum and allegedly, Norma Newton, ever pursued their interest in such employment. Barnum was the only Hob Nob employee who filled out an application, and he was offered a job. (Tr. 204.) He decided to go to work elsewhere. (Tr. 207.)

Benton Lee Hart, a former Hob Nob employee, testified that he was told that if he desired employment by petitioner, to apply. (Tr. 140.) He was told that petitioner would be non-union. (Tr. 137.) He heard at a union meeting that petitioner "had hired all butchers", but on cross-examination, he admitted that he "was not interested" in what he heard "because it was just hearsay". (Tr. 142-143.)

Donald Hinds, another former Hob Nob employee, testified that on the evening of his last day at work, he saw William Young, who told him petitioner had all its qualified meat cutters. (Tr. 147.) Young was very busy at the time and "had a bunch of papers in front of him". (Tr. 149.) Hinds also testified that "either the following day or the second day after the sale of the stores", there was a meeting of the former Hob Nob employees at the Local 193 office, and the employees discussed "the condition of sale, the fact that they were going to be—right then they were supposed to be non-union—a non-union store—and what the chances of the future there might be". (Tr. 147.)

Argus Turner, a third former Hob Nob employee, testified that petitioner's meat supervisor told him that petitioner "had plenty of butchers". (Tr. 200.)

Hart, Hinds and Turner, along with the other Hob Nob employees, did not apply for employment. No one prevented them from doing so.

The statement attributed to petitioner that it would be non-union was not a violation of the Act. *NLRB v. New England Tank Industries,* supra, 302 F.2d 273, 276. Nor were the statements that petitioner had the butchers it needed. If at the time, petitioner thought that the number of butchers it had arranged for was sufficient, there was no reason why it should have withheld that information. Petitioner was not obliged to give preference to the former Hob Nob employees over other applicants for employment. *Bedford-Nugent Corp.,* 151 NLRB No. 26 (1965).

A discriminatory refusal to hire was not complained of, and as noted, such a theory finds no evidentiary support. Therefore, there is no basis for the requirement that petitioner offer reinstatement to the former Hob Nob employees. It is a probable result that such action would displace petitioner's employees.

NLRB action is not insulated from judicial review where it has applied a remedy it claims it has worked out on the basis of its expertise, without regard to the circumstances which may make its application to a particular situation oppressive and not calculated to effect a policy of the Act. *NLRB v. Flomatic Corp.,* supra, 347 F.2d 74, at 77.

IV. THERE IS A LACK OF SUBSTANTIAL EVIDENCE TO SUPPORT THE FINDINGS OF INDIVIDUAL DISCRIMINATION AND THE FINDING OF THE SINGLE EMPLOYER.

Even after discounting all explanations offered by an employer, the NLRB still must find unlawful motivation through substantial evidence in order to conclude that an employer violated Section 8(a)(3). *Riggs Distler & Co., Inc. v. NLRB,* 327 F.2d 575, 55 LRRM 2145 (C.A. 4, 1963); *NLRB v. Coca-Cola Bottling Co.,* 333 F.2d 181, 56 LRRM 2562 (C.A. 7, 1964).

Conclusions based on surmise or conjecture can not stand. *NLRB v. Covington Motor Co.,* 344 F.2d 136, 58 LRRM 2811 (C.A. 4, 1965); *NLRB v. Deerfield Screw Products Co.,* 329 F.2d 558 (C.A. 6, 1964).

Nowhere is this better demonstrated than as to the findings and conclusions regarding Jack Baldwin.

Baldwin

There is no evidence of union activities by Baldwin while he was in petitioner's employ.

At first Baldwin was employed at Jack Young's Supermarket (herein, "Jack Young"), located on Brundage Lane in Bakersfield. There is no evidence of union activities by Baldwin while he worked there.

There was a picket line of another union at Jack Young's. Cleo Thompson, the meat supervisor, asked Baldwin if he wanted to cross the picket line. (Tr. 153.) Thompson said that "there wasn't really any problem, if I wanted to go across the picket line I could go, and if I didn't want to go across the picket

line I could go to the other store". (Tr. 154.) Baldwin went to the other store and to work for petitioner. The trial examiner saw this as "but another example of Respondent's connivance with Jack Young in meeting the thrust of union organization in the Brundage Store" and as "further indicative of Respondent's collaboration with Jack Young in combatting unionism." (Trial Examiner's Decision, pp. 8-9.)

Since there is no evidence in the record that Jack Young was combatting unionism, the Trial Examiner's views border on light fantasia. During all of 1964 there was a collective bargaining agreement between Jack Young and Local 193 (Tr. 12), and at the time of the hearing the parties were negotiating for a new one (Tr. 50-51).

Arranging work for Baldwin elsewhere, thereby respecting his decision not to cross the picket line, is hardly evidence of discrimination.

Baldwin was later promoted from meat cutter to head meat cutter. (Tr. 187.) His promotion is hardly evidence of discrimination either.

Still later, Baldwin left petitioner's employ.

The Trial Examiner could not understand why Baldwin was let go while his assistant, an apprentice, was retained. The explanation is simple:

(1) A head meat cutter has administrative and supervisory duties an ordinary meat cutter does not have. (Tr. 336-339, 374.) The difference is recognized in the Local 193 collective bargaining agreement, which provides that "journeymen meat cutters per-

forming head meat cutters responsibility" shall be paid accordingly. (G. C. Exh. No. 2, p. 28.)

(2) While Baldwin was a fairly decent meat cutter (Tr. 312), he was a poor head meat cutter (Tr. 375). He was let go. An experienced head meat cutter took his place.

(3) The apprentice was retained as an assistant because apprentices are by nature assistants.

There is little, if any evidence that Baldwin's replacement was non-union. Baldwin testified that "from what I understand, he *is* not" a union member (Tr. 165), but there is no showing of the basis for such understanding.

The case for discrimination against Baldwin is flimsy. Bill Sing, a grocery department manager who had no supervision over the meat department (Tr. 182-183, 261), allegedly asked Baldwin if he was a union member. (Tr. 156-157.) It is difficult to see how or why that was discriminatory.

Brewton

The case for Imogene Brewton turns on her testimony that she was requested to work at Jack Young's store on Brundage Lane so that Charlene Pappin, a Jack Young's employee, could take her place at petitioner's Oildale (Roberts Lane) store and thereby, avoid having to become a union member. (Tr. 103; see also, for identification of Pappin as "the other girl" mentioned by Brewton, Tr. 305-306, 396, 397, 407.)

Union President Charles A. Hohlbein testified, however, that while at Jack Young's, Pappin *did* join the union. His testimony was this (Tr. 384):

> "And he took the application. He went in and talked to the girl and she came back out of the meat department and told me that she would have this filled out and for me to pick it up tomorrow, which she done."

The Trial Examiner found that testimony of Brewton's inefficiency was inconsistent with her status as an employee at Jack Young's and her transfer to petitioner's employ only 30 days prior to her discharge.

At the time Brewton was working at petitioner's Oildale (Roberts Lane) store, petitioner's Chester Street store had not been equipped with automatic labor-saving devices petitioner's other two stores had been equipped with. (Tr. 305.) Therefore, more help was needed at the Chester Street store. To keep down its overhead, petitioner was looking for an employee with sufficient speed to do at its Oildale store in part-time, what Brewton had been doing in full-time there, and still be available to work part-time at its Chester Street store. (Tr. 305-306, 327, 336.) Pappin had the speed to do both jobs in a day. (Tr. 306.) Brewton did not, and at the hearing she did not contend that she had.

There is no inconsistency in Brewton being able to perform satisfactorily in one situation but not in another, any more than in Jack Baldwin being a fairly decent meat cutter but a poor head meat cutter.

Neither Baldwin nor Newton were former Hob Nob employees.

Newton

Norma Newton worked for Hob Nob. Her testimony is that she telephoned William Young regarding a job. He asked her if she could start the next day, and when she said that she was unable to, he asked her to call back "in a couple of days". In response to a question, he said "we have our own union". (Tr. 222.)

Newton claimed that when she later called back, Young said he was Joe Wong and "bawled me out" for calling him. (Tr. 223.) She said that in a later conversation, Young told her that she would have to withdraw from the union. (Tr. 224.)

Disregarding William Young's denial that he ever talked to Norma Newton (Tr. 315-316), no reason is afforded or suggested by the record, and none is advanced by the NLRB, why William Young would say that he was Joe Wong, when he was not, or why he would say that he had his own union, when he did not. (Tr. 316.)

The "evidence" supporting the case for Norma Newton is not only flimsy but patently transparent.

The Single Employer

The NLRB concluded that petitioner and Jack Young's are a single employer within the meaning of the Act. The only substantial evidence is that they are not. The evidence may be summarized as follows:

1. Ownership. Jack Young owns more than 85% of the stock of Jack Young's. He owns none of petitioner's stock. (Tr. 282, 283.)

2. Acquisition. Petitioner's three stores were purchased by Bill Young and Jack Young, Jack Young's sons, as individuals, and they then formed a new corporation to operate the stores. (Tr. 283.)

3. Control. Jack Young, president and chief executive of Jack Young's, is not an officer or director of petitioner and he is not authorized to sign petitioner's checks. (Tr. 284, 291.)

4. Bank accounts, books of account, etc. They are separate. (Tr. 291.)

5. Sales—purchases. Meat is not purchased jointly by the two corporations, and no meat sold by one corporation has ever been paid for by the other. (Tr. 294.)

6. Taxes and licenses. They are paid by and are in the name of petitioner as respects its stores. (Tr. 295-297.)

7. Payment of wages. No employee of petitioner has ever been paid by Jack Young's for work performed at petitioner's stores. (Tr. 295.)

8. Advertising. While a common name is used for advertising, costs are prorated, and this is not uncommon in the retail grocery industry. (Tr. 257, 292-294.)

While William Young may have represented both petitioner and Jack Young's at times in the area of

labor relations, policy at Jack Young's is determined by Jack Young, and Jack Young does not decide petitioner's policy. (Tr. 297.)

Some exchange of employees and some degree of cooperation between two corporations does not amount to integration. See *Malcolm Konner Chevrolet Co.,* 141 NLRB No. 43 (1963); *Carl Rochet d.b.a. Renton News Record,* 136 NLRB 1294 (1962); *Park Plaza Amusement Co.,* 124 NLRB 428 (1959); *American Furniture Co.,* 116 NLRB 1496 (1956); *C. A. Batson Co.,* 108 NLRB 1332 (1954); *Jefferson Co.,* 105 NLRB 202 (1953); and *Clark Thread Co.,* 79 NLRB 542 (1948). See also, *M. Lowenstein & Sons, Inc.,* 150 NLRB No. 66 (1964).

CONCLUSION

For the reasons set forth herein the NLRB Decision and Order should be reversed and set aside.

Dated, Coalinga, California,
July 18, 1966.

Respectfully submitted,
FRAME & COURTNEY,
TED R. FRAME,
Attorneys for Petitioner.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Ted R. Frame,
Attorney for Petitioner.

(Appendix Follows)

Appendix

Appendix

TABLE OF EXHIBITS

Exhibit	Identification	In Evidence
General Counsel's:		
1(a)-1(y) (formal documents)	Tr. 5	Tr. 5
2 (collective bargaining agreements)	11	12
3 (letter, Specht to Hodson)	12	13
4 (letter, Hodson to Specht)	13	13
5 (letter, Frame to Hodson)	14	14
6 (letter, Hodson to petitioner)	15	15
7 (letter, Frame to Hodson)	15	15
8 (letter, Arak to petitioner)	15	16
9 (letter, Frame to Arak)	16	16
10 (contract of sale)	17	17
11(a)-(b) (Brewton paychecks)	97	99
12(a)-(b) (Brewton paychecks)	97	99
13(a)-(b) (Baldwin paychecks)	98	100
14(a)-(c) (Baldwin paychecks)	164	165
Petitioner's:		
1 (Representation petition)	20	20
2 (letter, Scully to Frame)	20	20
3 (letter, Hob Nob to Union)	73	73
4 (Brewton paychecks)	124	124
5 (Brewton paychecks)	125	125
6 (Brewton paychecks)	125	125
7 (sales volume record)	302	303
8 (list of employees)	302	
Union's:		
1 (newspaper ad)	69	69

No. 20,827

In the United States Court of Appeals for the Ninth Circuit

K. B. & J. YOUNG'S SUPER MARKETS, INC.,
PETITIONER

v.

NATIONAL LABOR RELATIONS BOARD, RESPONDENT

On Petition to Review and Set Aside and on Cross-Petition for Enforcement of an Order of the National Labor Relations Board

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

ARNOLD ORDMAN,
General Counsel,

DOMINICK L. MANOLI,
Associate General Counsel,

MARCEL MALLET-PREVOST,
Assistant General Counsel,

HERMAN M. LEVY,
MARSHA E. SWISS,
Attorneys,

National Labor Relations Board.

INDEX

	Page
Jurisdiction	1
Counterstatement of the case	2
I. The Board's findings of fact	2
A. Background	3
B. Petitioner purchases Kelley's and discharges all employees	5
C. Petitioner refuses to hire Kelley employees unless they withdraw from the Union	7
D. Petitioner discharges Imogene Brewton and Jack Baldwin	9
E. Petitioner refuses the Union's request to bargain	10
II. The Board's conclusions and order	11
Argument	12
I. Substantial evidence on the record as a whole supports the Board's conclusion that petitioner's conduct violated Section 8(a)(3) and (1) of the Act	12
A. Substantial evidence supports the Board's conclusion that petitioner violated Section 8(a)(3) and (1) of the Act by causing Kelley to discharge all employees prior to petitioner's assumption of operations	12
B. Substantial evidence supports the Board's finding that petitioner violated Section 8 (a)(3) and (1) of the Act by refusing to hire Norma Newton unless she withdrew from the Union	16
C. Substantial evidence on the record as a whole shows that petitioner violated Section 8(a)(3) and (1) by discharging Imogene Brewton and Jack Baldwin	18
1. Imogene Brewton	18
2. Jack Baldwin	19

Argument—Continued Page

II. Substantial evidence supports the Board's finding that petitioner violated Section 8(a)(5) and (1) of the Act by refusing to bargain with the Union as the collective bargaining representative of its employees 20

III. The Board's remedy is proper 23

Conclusion 24

Certificate 25

Appendix 26

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Editorial "El Imparcial" v. *N.L.R.B.*, 278 F. 2d 184 (C.A. 1) 13, 24

Local No. 152, Teamsters v. *N.L.R.B.*, 343 F. 2d 307 (C.A. D.C.) 24

Medo Photo Supply Corp. v. *N.L.R.B.*, 321 U.S. 678 24

N.L.R.B. v. *Armato*, 199 F. 2d 800 (C.A. 7) 21

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N.L.R.B. v. *Bird Machine Co.*, 161 F. 2d 589 (C.A. 1) 15

N.L.R.B. v. *Cape County Milling Co.*, 140 F. 2d 543 (C.A. 8) 22

N.L.R.B. v. *Colten*, 105 F. 2d 179 (C.A. 6) 21

N.L.R.B. v. *Cone Bros. Contracting Co.*, 317 F. 2d 3 (C.A. 5), cert. den., 375 U.S. 945 19

N.L.R.B. v. *Crean*, 326 F. 2d 391 (C.A. 7) 17

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N.L.R.B. v. *Downtown Bakery Corp.*, 330 F. 2d 921 (C.A. 6) 21

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Cases—Continued Page

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N.L.R.B. v. *Jones & Laughlin Steel Corp.*, 301 U.S. 1 23
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N.L.R.B. v. *McFarland*, 306 F. 2d 219 (C.A. 10) 21
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N.L.R.B. v. *Radcliffe*, 211 F. 2d 309 (C.A. 9), cert. den., 348 U.S. 833 17
N.L.R.B. v. *Sifers*, 171 F. 2d 63 (CA. 10) 22
N.L.R.B. v. *John Stepp's Friendly Ford, Inc.*, 338 F. 2d 833 (C.A. 9) 18-19, 21
N.L.R.B. v. *Tak Trak, Inc.*, 293 F. 2d 270 (C.A. 9), cert. den., 368 U.S. 938 13
N.L.R.B. v. *Tempest Shirt Mfg. Co.*, 285 F. 2d 1 (C.A. 5) 21
N.L.R.B. v. *Texas Indep. Oil Co., Inc.*, 232 F. 2d 447 (C.A. 9) 17, 20
N.L.R.B. v. *Walton Mfg. Co.*, 369 U.S. 404 18
N.L.R.B. v. *Wings & Wheels, Inc.*, 324 F. 2d 495 (C.A. 3) 13, 17
Phelps-Dodge Corp. v. *N.L.R.B.*, 313 U.S. 177 ..... 17, 23
Piasecki Aircraft Corp. v. *N.L.R.B.*, 280 F. 2d 575 (C.A. 3), cert. den., 364 U.S. 933 24
North Carolina Finishing Co. v. *N.L.R.B.*, 133 F. 2d 714 (C.A. 4), cert. den., 320 U.S. 738 15
Wackenhut Corp. v. *Intern. Union*, 332 F. 2d 954 (C.A. 9) 20
Wiley v. *Livingston*, 376 U.S. 543 ..... 20, 21

Statute: Page

National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Sec. 151, *et seq.*) 2

Section 2(3) 22
Section 8(a)(1) 2, 12, 16, 18, 20
Section 8(a)(3) 2, 12, 16, 18
Section 8(a)(5) 2, 20
Section 10(c) 2, 23
Section 10(e) 2
Section 10(f) 2

In the United States Court of Appeals for the Ninth Circuit

No. 20,827

K. B. & J. Young's Super Markets, Inc.,
PETITIONER

v.

National Labor Relations Board, RESPONDENT

On Petition to Review and Set Aside and on Cross-Petition for Enforcement of an Order of the National Labor Relations Board

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

JURISDICTION

This case is before the Court upon the petition of K. B. & J. Young's Super Markets, Inc., hereafter called petitioner, to review an order of the National Labor Relations Board (R. 52),[1] issued against peti-

[1] References to the pleadings reproduced as "Volume I, Pleadings" are designated "R." References to the stenographic transcript of the hearing reproduced pursuant to Court Rule 10 are designated "Tr." References preceding a semicolon are to the Board's findings; those following are to the supporting evidence. "G.C. Ex." refers to exhibits of the General Counsel. "Res. Ex." refers to petitioner's exhibits.

tioner on March 1, 1966, following proceedings under Section 10(c) of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Sec. 151, *et seq.*). In its answer to the petition, the Board requests enforcement of its order. The Board's Decision and Order are reported at 157 NLRB No. 17. This Court has jurisdiction of the proceedings under Section 10(e) and (f) of the Act, the unfair labor practice having occurred in Bakersfield, California, where petitioner is engaged in the retail sale of groceries. No issue of the Board's jurisdiction is presented.

COUNTERSTATEMENT OF THE CASE

I. The Board's Findings of Fact

Briefly, the Board found that petitioner violated Section 8(a)(5) and (1) of the Act by refusing to bargain with the Union [2] as the exclusive bargaining representative of its employees. The Board also found that petitioner violated Section 8(a)(3) and (1) of the Act by causing Kelley's Markets to discharge all meat market employees; by discharging employees Imogene Brewton because of her refusal to cross a picket line; by discharging Jack Baldwin because of his Union affiliation; and by conditioning the employment of Norma Newton upon her withdrawal from the Union. The facts upon which these findings are based are set forth below.

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[2] Butchers Union Local 193, Amalgamated Meat Cutters and Butcher Workmen of North America, AFL-CIO.

A. *Background*

Hob Nob Stores, Inc., a chain of retail grocery stores and a subsidiary of U.S. Food Stores, had three supermarkets in Bakersfield, California. These markets were located on Roberts Lane, Nile Street and Chester Avenue, and had been doing business under the name of Kelley's Markets for several years. The meat departments of all three stores were covered by a collective bargaining agreement between the Union and Kelley's executed on January 16, 1960, and effective until January 15, 1965,[3] (R. 29; Tr. 11-12, G.C. Exh. No. 2).

The collective bargaining agreement included, *inter alia*, a union shop clause which required that all employees shall join the Union within 30 days of their employment with Kelley as a condition for retaining their jobs (R. 30; G.C. Ex. No. 2).[4] As a result of

---

[3] Employees in the described unit were "all meat department employees, excluding all professional employees, guards, managers, supervisors, office clericals, janitors and other employees not specifically included."

[4] Union Shop

c. All Employees covered by this Agreement shall, on and after the thirtieth (30th) day following the beginning of their employment, or the effective date of this Agreement, whichever is the later, become members of the Union, and retain such membership during the period of this Agreement as a condition of employment, subject to the conditions of Section 8(a)(3) of the Labor-Management Relations Act of 1947.

Five Days Notice

d. It is further agreed that if an employee becomes delinquent in his Union dues, the Employer will, upon writ-

the union shop clause, all Kelley employees were members of the Union. The agreement also included an "acquisition clause" whereby the employer agreed that the contract "will apply to all employees performing work under the jurisdiction of Local 193 in all meat markets or departments that are now, or may be in the future, operated by said employer in the jurisdiction of Local 193" [5] (R. 37; G.C. Ex. No. 2).

Also in the Bakersfield area, at all times material to this case, was a two-store enterprise called Jack Young's. One of Jack Young's stores was situated on Brundage Lane, in Bakersfield, and the other was in Visalia, a neighboring community. Jack Young's was owned by Jack Young and by his two sons, William and Charles John Young, who were minority stock-

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ten notice, dismiss said employee unless within five (5) days, the employee shall have paid up the delinquent dues.

[5] ARTICLE 1—JURISDICTION AND RECOGNITION

Bargaining Unit

a. In order to assure the securing of benefits intended to be derived by the Employer and the employees under these Articles of Agreement, the Employer agrees that this Agreement will apply to all employees performing work under the jurisdiction of Local 193 in all meat markets or departments that are now, or may be in the future, operated by said employer in the jurisdiction of Local 193.

The contract was a so-called area contract, in that its provisions were imposed by Local 193 upon all employers in the Los Angeles area whose employees had designated the Local as their bargaining representative.

holders in the enterprise. (R. 30; Tr. 282-283). Meat department employees in the Jack Young's stores were also represented by Local 193 of the Union, and bound by the same area contract which constituted the agreement between Kelley's and the Union (R. 37; Tr. 11-12). Thus, an acquisition clause provided for automatic Union representation of all Jack Young meat departments which may be acquired by Young after execution of the contract. A union-security clause required that all new Jack Young employees join the Union within 30 days after the commencement of their employment.

B. *Petitioner purchases Kelley's and discharges all employees*

During April 1964, Bill and Charles John Young began negotiations for the purchase of Kelley's (Tr. 239). The parties signed the agreement of purchase and sale on April 8, 1964, (G.C. Ex. No. 10).[6] At this time, the Youngs said that they wanted to hire their own employees, and as part of the sales agreement the parties reached an unwritten understanding that Kelley's would terminate the current employees at the three stores. (R. 30; Tr. 246.) Kelley's then terminated all employees on April 20, 1964, their last day of operation. (R. 32; Tr. 247.) Prior to this date neither the employees nor the Union received any notice of the sale and termination of employment.

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[6] The new owners intended to call their stores K. B. & J. Young's Supermarkets.

(R. 32; Tr. 26-27, 134, 146, 199, 203). Immediately after the sale, the stores were closed for one day during which inventory was taken.

On April 21, 1964, Harold Hodson, the Union business agent, received written notice from Kelley's stating it was discontinuing business in the area and notifying him of the termination of the collective bargaining agreement (R. 32; Tr. 26-27). Hodson also learned of the sale from Michelleti, the Union representative who serviced the Kelley's contract (Tr. 27). Michelleti told Hodson that "there was going to be some problem about the collective bargaining agreement because in the conversations he had had with the Youngs, they had informed him that they were not going to honor the Butchers collective bargaining agreement" (R. 32; Tr. 29).

Subsequent to petitioner's acquisition of the three Kelley stores William Young became general manager of both Jack Young's and petitioner's operations, and in this capacity set the labor relations policy for both enterprises. (Tr. 33, 322, 328, 47-52.) Cleo Thompson supervised the meat department at Jack Young's and at petitioner's stores. (Tr. 333-335.) The four Bakersfield area stores advertised in the local newspaper jointly under the name of Young's Supermarkets and charged identical prices. (Tr. 292.) Petitioner's employees received checks drawn on the Jack Young's account through June 1964. (G.C. Ex. Nos. 11(a)-14(c). Tr. 96-101, 162-165). Meat was transferred from

time to time between Jack Young's and petitioner's stores (Tr. 333). Petitioner's bookkeeper maintained his office at Jack Young's Visalia store (Tr. 341). Applicants for jobs at petitioner's stores were instructed to appear at Jack Young's for interviews and once hired, often worked for both corporations during the course of the same week. (R. 35; Tr. 59-65.)

C. *Petitioner refuses to hire Kelley employees unless they withdraw from the Union*

Benton Lee Hart, a Kelley employee for six years, learned of the sale of Kelley's on April 20, when Cleo Thompson, petitioner's meat department supervisor, informed Hart that he was terminated. Thompson told him that he could apply at the "head Office—Jack Young's Brundage Street store—" for employment with the new owners, but that the markets would be non-union thereafter (R. 32; Tr. 134, 136).

Kelley's meat cutter, Donald Hinds, asked William Young, on the evening of April 20, 1964, when it would be convenient to apply for a job with the new owners. Young replied that K. B. & J. "had all the meat cutters they needed." (R. 32.) Hinds later informed the other Kelley meat cutters and wrappers of his conversation with William Young, during the course of a union meeting on April 21, 1964, (R. 33; Tr. 146-147).

When Argus Turner asked supervisor Thompson about re-employment with petitioner, Thompson told him that "he had plenty of butchers" (R. 33; Tr. 200).

Forbes Barnum was a head meat cutter at Kelley's who also asked William Young about gaining employment with K. B. & J. (Tr. 203). Young instructed him to fill out on application at Jack Young's Brundage Street Store. (Tr. 204.) Barnum filled out this application on April 21, 1964. That night he received a call from William Young who asked whether Barnum knew anyone else interested in working for K. B. & J. (Tr. 205.) Young left his phone number with Barnum to give to prospective employees. (Tr. 205-206.) Barnum's wife, in his absence, received a call from Young who asked her to tell her husband that if he wanted to go to work for K. B. & J. he would have to get a withdrawal card from the Union. (Tr. 213-214.) Barnum found other employment. When Thompson called him to ask why he had not reported for work, Barnum replied that he did not feel he "should get out of the union to work." Thompson agreed that in that case he was better off working for another employer and added that if Barnum wanted to work for Young's he would have to get out of the Union (R. 33; Tr. 209-210).

Norma Newton was a Kelley's meat wrapper. She telephoned William Young pursuant to instructions conveyed to her by Forbes Barnum to ask about employment with K. B. & J. Young asked her to report for work the next day. (Tr. 221-222.) In answer to Newton's inquiry as to whether K. B. & J. was going "to be union," Young replied, "We have our own Union." (Tr. 222.) Newton requested a delay in her employment, and when she next spoke to Young again, he told her to "go by the Union and get

your withdrawal card and then come in." Newton said she could not work without a union. Young answered, "Well, then, forget it." (R. 33; Tr. 224.)

D. *Petitioner discharges Imogene Brewton and Jack Baldwin*

Imogene Brewton had worked for Jack Young's Supermarket until May 11, 1964, when William Young transferred her to petitioner's Roberts Lane Store. (Tr. 92-93.) She worked there until June 13, 1964, when supervisor Thompson told her that he wanted to transfer her back to the Jack Young's Brundage Street Store and transfer a new Brundage Street employee, Charlene Pappin, to petitioner's Roberts Lane Store, so that Pappin would not have to join the union under the union-security clause in the contract operative at Jack Young's. (Tr. 102-103.) Union representative Hohlbein had, without success, requested Young to require Pappin to meet the requirements of the union-security clause. (Tr. 382.) Since the Brundage Street Store was at this time being picketed by another labor union, Brewton, not wanting to cross the picket line, declined to transfer. Thompson told Brewton to make up her mind whose side she was on, Young's or the Union's. When Brewton stated that she definitely would not cross the picket line, Thompson discharged her. (R. 34; Tr. 103-106.)

Jack Baldwin had been employed by Jack Young's Brundage Street Store as a meat cutter since February 1964. On June 1, 1964, he was offered a transfer to one of petitioner's stores so that he would not have

to cross the picket line established at the Jack Young's. (Tr. 153-155.) Having chosen to transfer, he began to work at the petitioner's Chester Avenue store managed by Bill Sing. Sing asked Baldwin why he belonged to the Union. (Tr. 156-157.) Baldwin replied that he "felt like it." (Tr. 157.) When Baldwin returned from his vacation soon afterwards, William Young called him to tell him that he would not be needed. (Tr. 157.) Shortly before his discharge Baldwin had been promoted to the job as head meat cutter at the Chester Street Store. (Tr. 187-188.) Although Baldwin was discharged, his sole apprentice at the store was retained and another employee was transferred to Baldwin's job. (R. 35; Tr. 161-162, 191-192.)

E. *Petitioner refuses the Union's request to bargain*

On May 19, 1964, Union Secretary-Treasurer Harold Hodson and Union president Charles Hohlbein entered the Jack Young's Brundage Lane Market in order to ask William Young to honor the unexpired contract which the Union had with the Kelley stores. Young refused to discuss the matter except to deny the request and to refuse to make payments to the health and welfare plan required by the contract. (R. 37; Tr. 31-32.)

Hodson then notified Respondent's agent, Valley Employers Association, of the Union's demand. (Tr. 35-36.) He received the following answer in a letter signed by H. Joseph Specht on behalf of the Association.

> On Tuesday, May 19, 1964, you phoned me and claimed you represented the employees of Young's Super Markets located on South Chester, Roberts Lane and Nile Street in Bakersfield.
>
> For and on behalf of our member, please be advised the Employer, K. B. & J. Young's Supermarkets, Inc. declines recognition of your Union, Butchers Local 193.
>
> These three stores were recently purchased and the prevailing Employer terminated all the employees. The present Employer has hired all new employees and your request that these employees join your union within 31 days is evidence enough of the employers good faith doubt that you represent a majority of these employees. (G.C. Ex. No. 3, Tr. 36-37.)

Later, in November 1964, Hohlbein and Hodson contacted William Young again in an attempt to enforce the union-security provisions of the contract. (Tr. 34, 46-50.) In December 1964, the Union also gave a "reopener" notice pursuant to the agreement, but petitioner rejected all such demands, and since that time has refused to bargain with the Union. (R. 38; Tr. 54, 74.)

II. The Board's Conclusions and Order

On the basis of the foregoing facts, the Board found that petitioner violated Section 8(a)(3) and (1) of the Act by causing Kelley to discharge all its employees; by discharging Imogene Brewton for refusing to cross a picket line; by discharging Jack Baldwin because of his Union affiliation and by conditioning the employment of Norma Newton on her

withdrawal from the Union. The Board also found that petitioner violated Section 8(a)(5) and (1) of the Act by refusing to bargain with the Union as the exclusive representative of its employees whom petitioner had discriminatorily discharged.

The Board's order requires petitioner to cease and desist from the unfair labor practices found and from in any other manner impinging on employee's rights guaranteed by the Act. Affirmatively, the order requires petitioner to recognize and bargain with the Union upon request, to offer all Kelley's meat department employees reinstatement and backpay, to offer Imogene Brewton and Jack Baldwin reinstatement and backpay and to post the customary notices (R. 40-41).

ARGUMENT

I. Substantial Evidence on the Record as a Whole Supports the Board's Conclusion That Petitioner's Conduct Violated Section 8(a)(3) and (1) of the Act

A. *Substantial evidence supports the Board's conclusion that petitioner violated Section 8(a)(3) and (1) of the Act by causing Kelley to discharge all employees prior to petitioner's assumption of operations*

The Board found that petitioner caused Kelley to discharge the Kelley employees, all of whom, as petitioners knew, were required by their collective bargaining agreement with Kelley to be Union members. The Board further found that the basis of these discharges was the employees' Union affiliation and that petitioner's purpose in securing their discharge was to avoid an obligation imposed by the Act to bargain with the Union which represented all the employees.

It is well settled that discharge of employees under such circumstances is prohibited by the Act. *N.L.R.B.* v. *Tak-Trak, Inc.*, 293 F. 2d 270, 271 (C.A. 9), cert. denied, 368 U.S. 938; *N.L.R.B.* v. *Wings & Wheels, Inc.*, 324 F. 2d 495, 496 (C.A. 3); *N.L.R.B.* v. *Lively Service Co.*, 290 F. 2d 205, 206 (C.A. 10); *Editorial "El Imparcial"* v. *N.L.R.B.*, 278 F. 2d 184, 187 (C.A. 1).

Support for the Board's conclusion that the employees were discriminatorily discharged is shown not only by the insubstantiality of the reasons assigned by petitioner for the discharges, but also by petitioner's actions in refusing to hire certain employees unless they withdrew from the Union, petitioner's discharge of other employees because of their Union sympathies, and petitioner's cooperation with Jack Young's in that employer's attempts to frustrate union organization. The refusal to hire, the discharges, and the cooperation with Jack Young's as we show, *infra*, demonstrate petitioner's anti-union animus and make evident that petitioner's discharge of all the employees was part of a course of action designed to rid itself of Union members and thereby avoid its statutory obligations.

Petitioner sought to explain the discharges by alleging that the employees were inefficient. This reason as noted by the Trial Examiner was general and unconvincing. As the Trial Examiner stated (R. 36):

> * * * It was not until after his return to the witness stand after an intervening witness (his brother) that William Young was able to recall that he observed any meat market employees of

> Kelley at work and, as he admitted, any failure of efficiency on their part may have been due, at that late date, to the fact that they may have heard rumors of Respondent's acquisition of the Kelley markets, and, accordingly, were somewhat disorganized. Charles Young in his testimony that he observed meat market employees gossiping and drinking coffee apparently took no account of the fact that under Kelley's union agreement employees were allowed a coffee break. The overall description of Kelley employees as "lackadaisical" by both William and Charles impressed me as being no more than a catchall description to cover up any real observation by either of them of the day by day performance of Kelley employees, and both admitted that it was Kelley's methods of merchandising as well as employee inefficiency that in their opinion accounting for Kelley's losses.

Petitioner also testified that the discharges took place in order to permit petitioner to screen and hire its own personnel (Tr. 250, 287). Other facts, however, belie such a contention. Some dischargees who applied almost immediately for employment were told that petitioner already had all the meat cutters it needed, while two others, Barnum, a meat cutter, and Newton, a meat wrapper, as indicated, *supra,* were informed that employment would be available to them provided they withdrew from the Union. Thus, the record shows that whatever screening might have been intended by petitioner was for a purpose violative of the Act. In sum, the reasons which were offered by petitioner to explain the discharge fail to

withstand scrutiny and buttress the Board conclusion the petitioner discharged all the employees because of their Union affiliation. *N.L.R.B.* v. *Dant & Russell*, 207 F. 2d 165, 167 (C.A. 9); *N.L.R.B.* v. *Griggs Equipment, Inc.*, 307 F. 2d 275, 278 (C.A. 5); *N.L.R.B.* v. *Bird Machine Co.*, 161 F. 2d 589, 592 (C.A. 1); *North Carolina Finishing Co.* v. *N.L.R.B.*, 133 F. 2d 714, 718 (C.A. 4), cert. denied, 320 U.S. 738.

Other evidence bearing on the Board's conclusion that the discharge of the employees was discriminatorily motivated is supplied by petitioner's conduct with respect to Jack Young's. The record shows petitioner's supervisor Thompson sought to retransfer employee Brewton from one of petitioner's stores to Jack Young's where she had been originally employed. The purpose of this retransfer was to permit employee Charlene Pappin to transfer to petitioner's store and to have her avoid joining the Union at Jack Young's where a union security clause in Jack Young's contract would require Pappin to become a Union member.[7] The credited evidence also

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[7] Petitioner points out in its brief, p. 23, that according to the testimony of Union President Hohlbein, Pappin eventually joined the Union at Jack Young's. The fact that she ultimately joined, however, does not mitigate the evidence which amply demonstrates William Young's resistence in his capacity as manager at Jack Young's, to the union-security clause in the contract. Thus, Pappin told Hohlbein, when he asked her to take out membership, "I am not supposed to join the Union," (Tr. 386). And on a previous occasion, as Hohlbein testified, "She said she would like to (join the Union), but she was afraid to because she has been told not to" . . . "She used the term 'they don't want me to,' she said she had no objections herself" (Tr. 387).

shows that when employee Brewton refused to cross a picket line at Jack Young's, petitioner discharged her.

It is clear, as found by the Board, that petitioner's cooperation with Jack Young's in this enterprise's anti-union activities, is germane to the issue of petitioner's motivation in causing Kelley to discharge all its employees prior to petitioner's assumption of operations,[8] and supports the conclusion that these discharges were for a purpose prohibited by the Act.

B. ***Substantial evidence supports the Board's finding that petitioner violated Section 8(a)(3) and (1) of the Act by refusing to hire Norma Newton unless she withdrew from the Union***

As shown in the Counterstatement of Facts, Norma Newton, had been a meat wrapper at Kelley's prior to her discharge. Pursuant to information conveyed to her by Forbes Barnum, another employee, Newton called petitioner to inquire about employment. William Young, petitioner's owner, told her to report for work the next day. Newton inquired whether petitioner was going to be union and Young replied that they had their own union. Newton requested a delay

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[8] The facts set forth, *supra*, fully support the Board's conclusion that petitioner and Jack Young's constituted a single employer within the meaning of the Act. Whether petitioner and Jack Young be considered a single employer or whether petitioner be held accountable for events involving Jack Young's because of the dual capacities served by supervisor Thompson and William Young at both enterprises, the events concerning Jack Young's are significant for showing petitioner's motivation.

in employment. When she called Young again, he told her to "go by the Union and get your withdrawal card and then come in." Newton replied that she could not work without a union and Young answered "Well, then forget it." [9] An employer's refusal to hire because of the applicant's union affiliations violates Section 8(a)(3) and (1) of the Act. *Phelps Dodge* v. *N.L.R.B.*, 313 U.S. 177, 182-187; *N.L.R.B.* v. *Texas Independent Oil Co.*, 232 F. 2d 447, 449 (C.A. 9); *N.L.R.B.* v. *Crean*, 326 F. 2d 391, 394 (C.A. 7); *N.L.R.B.* v. *New England Tank Industries, Inc.*, 302 F. 2d 273, 277 (C.A. 1), cert. denied, 371 U.S. 875; *N.L.R.B.* v. *Wings and Wheels, Inc.*, 324 F. 2d 495, 496 (C.A. 3).

Petitioner's defense amounts to little more than a contention that testimony other than Newton's should have been credited and consequently a different conclusion reached. The findings with respect to Newton are based upon the Trial Examiner's credibility resolutions which were adopted by the Board and which, as this Court has long noted, are for determination by the trier of fact and are not to be lightly overturned. *N.L.R.B.* v. *International Brotherhood of Electrical Workers*, 301 F. 2d 824, 827-828 (C.A. 9); *N.L.R.B.* v. *Radcliffe*, 211 F. 2d 309, 315 (C.A. 9), cert. denied, 348 U.S. 833; *N.L.R.B.* v. *Lozano Enter-*

---

[9] Newton's experience with respect to the request to withdraw from the Union was similar to Forbes Barnum. When Barnum applied for work, petitioner made clear that Barnum's employment was contingent upon his withdrawal from the Union. Barnum, however, found other employment and did not report to work for petitioner.

prises, 318 F. 2d 41, 43 (C.A. 9); *N.L.R.B.* v. *Malone Trucking*, 278 F. 2d 92, 95 (C.A. 1); see *N.L.R.B.* v. *Walton Mfg. Co.*, 369 U.S. 404, 406-408.

C. *Substantial evidence on the record as a whole shows that petitioner violated Section 8(a)(3) and (1) by discharging Imogene Brewton and Jack Baldwin*

1. *Imogene Brewton*

As shown by the Counterstatement, William Young transferred Imogene Brewton from Jack Young's Supermarket where she had worked as a regular employee to petitioner's Roberts Lane Store. One month later, supervisor Thompson arranged to transfer her back to Jack Young's and to transfer Charlene Pappin, a new Jack Young's employee, to the Roberts Lane Store so that Pappin could avoid joining the Union under the union-security clause in effect at Jack Young's. Union Representative Hodson had tried on several occasions, but in vain, to make Young comply with the union-security clause.

Jack Young's at this time was being picketed by another labor union. Brewton did not wish to cross the picket line and consequently declined to transfer. Thompson asked whether the Union would get her another job if she lost her current job by refusing to cross the picket line. He told her to make up her mind whose side she was on, Young's or the Union's. When Brewton still refused to cross the picket line, Thompson discharged her. Petitioner's discharge of Brewton for this reason clearly violates Section 8(a)(3) and (1) of the Act. *N.L.R.B.* v. *John Stepp's*

Friendly Ford, Inc., 338 F. 2d 833, 836 (C.A. 9); *N.L.R.B.* v. *Cone Bros. Contracting Co.*, 317 F. 2d 3, 8 (C.A. 5), cert. den., 375 U.S. 945.

Although petitioner introduced other testimony in an attempt to support its theory that Brewton was discharged for inefficiency, the Trial Examiner did not credit the testimony of these witnesses.[10] As this Court has stated, "In large part the findings as to motivation represent an evaluation as to credibility. As to that, we are bound to accept the Examiner's appraisal." *N.L.R.B.* v. *International Brotherhood of Electrical Workers, Local Union 340, AFL-CIO*, 301 F. 2d 824, 827-828 (C.A. 9). See also cases cited, *supra*, p. p17-18.

2. *Jack Baldwin*

As detailed in the Counterstatement, Baldwin worked at the Jack Young's Store until February 1964, when a picket line established there prompted Thompson to offer to transfer Baldwin to petitioner's Chester Avenue Store. At petitioner's store, Baldwin held the position of head meat cutter and had one apprentice working under him. A few weeks after the transfer, Bill Sing, manager of the Chester Street Store, a man "in complete charge of the store," asked Baldwin if he belonged to the Union (Tr. 156, 261). Sing also asked why he belonged to the Union, and Baldwin replied "because I felt like it." (Tr. 157.)

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[10] The Trial Examiner noted that testimony of Brewton's inefficiency was inconsistent with her status as an employee at Jack Young's Brundage store and her transfer to petitioner's employ only some 30 days prior to her discharge.

Shortly thereafter, when Baldwin returned from vacation William Young discharged him.

Petitioner contended that Baldwin had been discharged because business was slow. The record, however, shows that following Baldwin's discharge, his apprentice was retained and another employee was transferred to Baldwin's job. In addition, the sales record of this store during this period fails to show that there was any appreciable decline in petitioner's business to support petitioner's contention (Res. Ex. 7). Even assuming that some valid reason might have existed for Baldwin's discharge, it is no less a violation of the Act where the facts show that the moving cause for the discharge was Baldwin's Union affiliations. *N.L.R.B.* v. *Texas Independent Oil Co.*, 232 F. 2d 447, 450 (C.A. 9); *Bon Hennings Logging Co.* v. *N.L.R.B.*, 308 F. 2d 548, 554 (C.A. 9).

II. Substantial Evidence Supports the Board's Finding That Petitioner Violated Section 8(a)(5) and (1) of the Act by Refusing to Bargain With the Union as the Collective Bargaining Representative of Its Employees

It is well established that following the purchase of a business which remains essentially the same after the transfer of ownership, the purchaser, as the successor to the business, is bound by certain aspects of the collective bargaining relationship established prior to the transfer. *Wiley* v. *Livingston*, 376 U.S. 543; *N.L.R.B.* v. *Auto Ventshade*, 276 F. 2d 303 (C.A. 5); *Wackenhut Corp.* v. *International Union*, 332 F. 2d 954, 958 (C.A. 9); *N.L.R.B.* v. *Hoppes Mfg. Co.*, 170 F. 2d 962, 964 (C.A. 6); *N.L.R.B.* v.

Lunder Shoe Corp., 211 F. 2d 284, 286 (C.A. 1); *N.L.R.B.* v. *McFarland*, 306 F. 2d 219 (C.A. 10); *N.L.R.B.* v. *Downtown Bakery Corp.*, 330 F. 2d 921, 925 (C.A. 6); *N.L.R.B.* v. *Colten*, 105 F. 2d 179, 183 (C.A. 6); *N.L.R.B.* v. *Armato*, 199 F. 2d 800, 803 (C.A. 7); *N.L.R.B.* v. *Tempest Shirt Mfg. Co.*, 285 F. 2d 1, (C.A. 5); cf. *N.L.R.B.* v. *Stepp's Friendly Ford*, 338 F. 2d 833 (C.A. 9). As these cases show, a successor: has been required to arbitrate pursuant to a collective bargaining agreement between a union and another employer *Wiley* v. *Livingston, supra;* has been held responsible for remedying the unfair labor practices of the predecessor *N.L.R.B.* v. *Tempest Shirt Mfg. Co., supra;* and has been required to bargain with the union which represented a majority of employees prior to the sale of business *N.L.R.B.* v. *Auto Ventshade, supra.*

We submit that the instant case is controlled by the above precedents. As shown by the undisputed facts, *supra*, petitioner purchased Kelley's three stores in April 1965 and petitioner's newly-acquired business remained essentially the same as the seller's. There is no question of the Union's majority status at the time of the sale. Petitioner admits that it caused Kelley to discharge all employees just prior to petitioner's assumption of operations. It is further not disputed that at the time of their discharge, all employees were members of the Union pursuant to a collective bargaining agreement between Kelley and the Union. As we have shown, *supra*, the evidence fully supports the Board's conclusion that the employees were discharged because of their Union af-

filiations and in an attempt by petitioner to avoid its legal obligations to their Union representative. Having found that the employees were discriminatorily discharged, the Board properly concluded that these employees never lost their status as employees of the business. *N.L.R.B.* v. *Sifers*, 171 F. 2d 63, 66 (C.A. 10); *N.L.R.B.* v. *Cape County Milling Co.*, 140 F. 2d 543, 546 (C.A. 8); *N.L.R.B.* v. *Greenebaum Tanning Co.*, 110 F. 2d 984, 989 (C.A. 7), cert. denied, 311 U.S. 662.[11] Accordingly, petitioner was required to bargain with the representative of these employees. As the Court of Appeals for the Tenth Circuit noted in *N.L.R.B.* v. *Sifers*, *supra*, at p. 66; ". . . . since they were ousted from their jobs because of unfair labor practices, they remained employees for the purpose of determining majority representation by the Union and collective bargaining obligations of the respondent."

The uncontested facts further show that shortly after the sale of the stores and the discharge of the employees, the Union requested petitioner to bargain with it and that petitioner refused to bargain with the Union. The Union's subsequent requests that petitioner bargain were similarly rejected. Since petitioner is required to bargain with the majority representative of its employees, its refusal to do so violates Section 8(a)(5) and (1) of the Act.

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[11] Section 2(3) defines employee to include . . . . "any individual whose work has ceased as a consequence of, or in connection with, any current labor dispute or because of any unfair labor practice . . . .

III. The Board's Remedy Is Proper

Having found that petitioner discriminatorily discharged all the Kelley employees as well as employees Brewton and Baldwin, the Board properly ordered the unfair labor practice be remedied by the reinstatement of these employees and the payment for any loss of pay suffered by reason of their discharges. Contrary to petitioner's suggestion, this order is appropriate and proper in situations where an employer has violated the Act by discriminatory discharges.[12] *N.L.R.B.* v. *Jones & Laughlin Steel Corp.*, 301 U.S. 1, 47-48; *Phelps Dodge Corp.* v. *N.L.R.B.*, 313 U.S. 177, 187.[13]

The Board noted in its decision that even if it had disagreed with the Trial Examiner's finding that petitioner had violated Section 8(a)(5) and (1) of the Act by refusing to bargain with the Union, it

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[12] Petitioner also argues that the Board's order of reinstatement and back pay is inappropriate because Kelley employees never sought to be hired by petitioner and therefore, petitioner could not be guilty of mass discriminatory refusal to hire Kelley employees (Pet. Br. 16-19). Accordingly, petitioner reasons, no violation having been shown, in the form of a refusal to hire, there is no basis for the Board's remedy. The Board order in the instant case, however, is based on the Board's finding that petitioner violated the Act by causing the discriminatory discharge of employees. It is clear that the Board's remedy of reinstatement and back pay is an appropriate one in such circumstances.

[13] Section 10(c) provides in relevant part that in remedying an unfair labor practice the Board shall "take such affirmative action including reinstatement of employees with or without backpay, as will effectuate the policies of this Act . . . ."

would still remedy the petitioner's discharge in violation of Section 8(a)(3) by requiring reinstatement, backpay and an additional order that petitioner bargain with the Union. See, *Piasecki Aircraft Corp.* v. *N.L.R.B.*, 280 F. 2d 575 (C.A. 3), cert. denied, 364 U.S. 933; *Local No. 152, Teamsters* v. *N.L.R.B.*, 343 F. 2d 307, 309 (C.A.D.C.); *Editorial "El Imparcial"* v. *N.L.R.B.*, 278 F. 2d 184, 187 (C.A. 1). For a remedy to provide for less in these circumstances would be to permit petitioner to benefit from its own violation of the Act. *Medo Corp.* v. *N.L.R.B.*, 321 U.S. 678, 687.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that a decree should issue dismissing the petition to review and enforcing the Board's order in full.

ARNOLD ORDMAN,
General Counsel,

DOMINICK L. MANOLI,
Associate General Counsel,

MARCEL MALLET-PREVOST,
Assistant General Counsel,

HERMAN M. LEVY,
MARSHA E. SWISS,
Attorneys,

National Labor Relations Board.

August 1966.

Certificate

The undersigned certifies that he has examined the provisions of Rules 18 and 19 of this Court and in his opinion the tendered brief conforms to all requirements.

Marcel Mallet-Prevost
Assistant General Counsel
National Labor Relations Board

APPENDIX

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Secs. 151, *et seq.*) are as follows:

Rights of Employees

Sec. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8(a)(3).

Unfair Labor Practices

Sec. 8. (a) It shall be an unfair labor practice for an employer—

(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7;

* * * *

(3) by discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization:

* * * *

(5) to refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 9 (a).

* * * *

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No. 20,827

IN THE

United States Court of Appeals

For the Ninth Circuit

. B. & J. Young's Super Markets, Inc., *Petitioner*

vs.

National Labor Relations Board, *Respondent*

PETITIONER'S REPLY BRIEF

rame & Courtney,
330 North Fifth Street,
Coalinga, California,
Attorneys for Petitioner.

rnau-Walsh Printing Co., San Francisco

Subject Index

	Page
Preliminary statement	1
Reply	1
I. A purchaser is not required to be a successor	1
II. Petitioner is not a successor	3
III. The findings of individual discrimination and single employer: fact or fiction?	5
Conclusion	9

Table of Authorities Cited

	Page
Brooks v. N.L.R.B., 348 U.S. 96, 75 S. Ct. 176 (1954)	4
Gifford-Hill & Co., 90 NLRB 428 (1950)	8
N.L.R.B. v. Fox Mfg. Co., 238 F. 2d 211 (C.A. 5, 1956)	7
N.L.R.B. v. John Stepp's Friendly Ford, Inc., 338 F. 2d 833 (C.A. 9, 1964)	4
N.L.R.B. v. L. G. Everist, Inc., 334 F. 2d 312 (C.A. 8, 1964)	8
N.L.R.B. v. McGahey, 233 F. 2d 406 (C.A. 5, 1956)	5
N.L.R.B. v. Red Rock Co., 187 F. 2d 76 (C.A. 5, 1951)	8
Northern California Chapter AGC, 119 NLRB 1026 (1955)	2
Tidelands Marine Service, 140 NLRB 288 (1962)	1

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IN THE

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vs.

NATIONAL LABOR RELATIONS BOARD, *Respondent*

PETITIONER'S REPLY BRIEF

PRELIMINARY STATEMENT

Respondent NLRB admits that its order is based on its finding that petitioner violated the Act by "causing" Hob Nob to terminate its employees. (Brief for NLRB, p. 23.) This simplifies the issues. It recognizes that except as to Norma Newton, there was no allegation of discriminatory refusal by petitioner to hire, and the case was not tried on that theory. Decisions such as *Tidelands Marine Service,* 140 N.L.R.B. 288 (1962), cited by Intervenor Local 193, are therefore not in point. (Brief for Intervenor, p. 10.)

REPLY

I. A PURCHASER IS NOT REQUIRED TO BE A SUCCESSOR.

As discussed in its opening brief, petitioner contends that it was free to request Hob Nob to terminate

its employees so that petitioner could hire its own employees. (Brief for petitioner, pp. 13-15.) Petitioner may have been motivated by a desire to minimize the impact of unionization, but there is nothing illegal about that.

This is not to say that in hiring its employees, petitioner was free to discriminate against former Hob Nob employees because of their union membership, but that was not complained of and respondent has now admitted that it is not the basis of the order.

What respondent's theory amounts to is that a purchase of a unionized business *must* become the successor of the seller and can not order its affairs not to. Respondent offers no authority in support of its theory.

Intervenor Local 193 states in its brief (p. 10) that where "a purchaser-employer, to evade an existing collective bargaining agreement, requires the termination by the seller of all of its employees, that purchaser has caused the discriminatory discharge of the employees and is in violation of Section 8(a)(3) of the Act." The case cited following the statement, *Northern California Chapter AGC,* 119 N.L.R.B. 1026 (1955), does not support it. That case involved a work stoppage by a striking union to cause a general contractor to terminate its contract with a sub-contractor unless the sub-contractor required its employees to join the striking union.

In the instant case petitioner did not coerce Hob Nob in any way. Petitioner and Hob Nob entered

ıto an arms-length business transaction. Sam Wahou, the president of U. S. Food Stores, Hob Nob's arent company, testified that he set a price and told he two Young brothers to take it or leave it. (Tr. 42.) While there was an understanding that the Youngs wanted to hire their own employees, it was ot a condition of the sale. (Tr. 252-253.)

Unless the purchaser of a unionized business must etain the employees of the seller, a proposition for hich there is no authority, respondent's Order for einstatement of the Hob Nob employees can not tand.

II. PETITIONER IS NOT A SUCCESSOR.

Obviously petitioner should not be required to barain with Local 193 unless petitioner is Hob Nob's uccessor within the meaning of the Act. It is meanıgless for respondent and Local 193 to argue that etitioner took action to evade its obligations as a uccessor unless petitioner had such obligations to egin with.

Both respondent and Local 193 cite numerous cases o establish that petitioner is Hob Nob's successor. Brief for NLRB, pp. 20-21; Brief for Intervenor, p. 4-5.) A careful review of each of those cases hows that they are cases in which the purchaser reained all or a substantial portion of the employees of he seller.

The question posed by the trial examiner, "Are you till a successor, although you have none of the em-

ployees of the predecessor?" (Tr. 410), is answered by this Court in *N.L.R.B. v. John Stepp's Friendly Ford, Inc.*, 338 F. 2d 833, 836 (C.A. 9, 1964):

> "The controlling question here, it would seem to us, is whether the new owner may rationally be said in substance, as to the unit in question, to have taken over and succeeded to his predecessor's employees. If he has not—if, on the contrary, he has within the unit in question secured his own employees—then he is not, as to the employees in question, a successor. He is their original employer. In such case both the employer and the employee unit are strangers to the certification and to the election upon which it was based. Nothing remains of the relationship to which the certification attached. Under such circumstances, in our judgment, the certification cannot stand."

Here, as in *Stepp's Friendly Ford,* there is no evidence of anything but an ordinary business transaction. There is nothing to suggest a sale by Hob Nob to an *alter-ego* in order to evade its agreement.

The cases cited by respondent and Local 193 are cases of certified unions. Local 193 was not certified. (Tr. 274-275.) Cf., *Brooks v. N.L.R.B.,* 348 U.S. 96, 75 S. Ct. 176 (1954).

Local 193 has never claimed to represent petitioner's present employees. The only claim Local 193 ever did make was that its collective bargaining agreement with Hob Nob or with Jack Young's Supermarket—it does not clearly appear which—was binding on petitioner. (Tr. 82-83, 90-91.)

II. THE FINDINGS OF INDIVIDUAL DISCRIMINATION AND SINGLE EMPLOYER: FACT OR FICTION?

Both respondent and Local 193 argue that the sales ecord for the Chester Street store, at which Jack aldwin was employed, does not support petitioner's ontention that business was slow at the time he was ischarged. (Brief for NLRB, p. 20; Brief for Inervenor, p. 13.) The argument ignores the facts.

Baldwin was discharged on August 30, or August 1, 1964. (Tr. 157.) During the week ending August 3, 1964, the prior week, as shown by petitioner's Exibit No. 7, both overall sales and sales at the Chester treet store were the lowest they had been for eight eeks. It does not appear from the record whether Villiam Young would have had before him the totals or the week ending August 31, 1964, at the time he alked with Baldwin, but if he had, there was not uch improvement. For the following week, that endg September 6, 1964, sales did not improve, but the ecord is silent as to Young's capacities as a seer.

There is pertinent language in *N.L.R.B. v. McahEy,* 233 F. 2d 406, 410, 412-413 (C.A. 5, 1956):

> "But the claim of an 8(a)(3) unlawful discharge of Ferguson, a shipping clerk, and Hollinger, a crane operator, stands quite differently. The finding of 8(a)(1) guilt does not automatically make a discharge an unlawful one or, by supplying a possible motive, allow the Board, without more, to conclude that the act of discharge was illegally inspired. Indeed, we have frequently sustained 8(a)(1) charges while rejecting those under 8(a)(3)."

* * * * * * *

"The Board's error is the frequent one in which the existence of the reasons stated by the employer as the basis for the discharge is evaluated in terms of its reasonableness. If the discharge was excessively harsh, if lesser forms of discipline would have been adequate, if the discharged employee was more, or just as, capable as the one left to do the job, or the like then, the argument runs, the employer must not actually have been motivated by a managerial consideration, and (here a full 180 degree swing is made) the stated reason thus dissipated as pretense, nought remains but antiunion purpose as the explanation. But as we have so often said: management is for management. Neither Board nor Court can second-guess it or give it gentle guidance by over-the-shoulder supervision. Management can discharge for good cause, or bad cause, or no cause at all. It has, as the master of its own business affairs, complete freedom with but one specific, definite qualification: it may not discharge when the real motivating purpose is to do that which Section 8(a)(3) forbids."

*   *   *   *   *   *   *

"Rotation in personnel is a common thing. The employer does not enter the fray with the burden of explanation. With discharge of employees a normal, lawful legitimate exercise of the prerogative of free management in a free society, the fact of discharge creates no presumption, nor does it furnish the inference that an illegal—not a proper—motive was its cause. An unlawful purpose is not lightly to be inferred. In the choice between lawful and unlawful motives, the record taken as a whole must present a substan-

tial basis of believable evidence pointing toward the unlawful one."

See also,

N.L.R.B. v. Fox Mfg. Co., 238 F. 2d 211 (C.A. 5, 1956).

Here, the record as a whole does establish unlawful notive for the discharge of Baldwin. He was offered ther employment so that he could observe a picket ine (Tr. 154), was promoted a short time later (Tr. 87), and never engaged in union activities. The fact hat while he was a "fairly decent meat cutter", he id not work out as a meat manager (Tr. 357), is unortunate but does not begin to show that Baldwin vas discharged because of union activity or memberhip.

As pointed out by petitioner in opening brief, while ne case for Imogene Brewton turns on her testimony hat she was requested to work at Jack Young's store n Brundage Lane so that Charlene Pappin, a Jack Young's employee, could take her place at petitioner's Dildale (Roberts Lane) store and thereby avoid aving to become a union member, the record is clear hat Pappin *did* join the union. (Tr. 384.) Respondnt speaks of Pappin having "eventually joined" the nion. (Brief for NLRB, p. 15.) This overlooks the act that Pappin joined while employed at Jack Young's. She left Jack Young's *before* taking Brewon's place. (Tr. 397.)

Petitioner's reason for requesting Brewton to work t Jack Young's was to improve the efficiency of its

operation. (Tr. 305-306, 327, 336.) A desire to improve or maintain business efficiency is a reasonable one even where a picket line is involved. *N.L.R.B. v. L. G. Everist, Inc.,* 334 F. 2d 312 (C.A. 8, 1964).

Norma Newton is discussed in petitioner's opening brief. There is no need to refer to her again here except to reiterate the inherently improbable nature of the conversations claimed by her in her testimony.

As to the "single employer" aspect of this case, it is admitted that William Young, with his brother John Young, effectively controlled petitioner's labor relations. However, at Jack Young's, William Young was a minority shareholder and subordinate to his father, Jack Young. The essential link of common control is missing. *N.L.R.B. v. Red Rock Co.,* 187 F. 2d 76 (C.A. 5, 1951), *Gifford-Hill & Co.,* 90 NLRB 428 (1950).

Local 193 stresses there were "interchanges of employees" between petitioner and Jack Young's. (Brief for Intervenor, p. 14.) Examination of the record (Tr. 58, et seq.) shows that for the most part, those were employees union representative Hodson saw working at Jack Young's in April, 1964, and later at one of petitioner's stores. "Interchange" implies two way movement, not leaving one job for a new one and remaining on the new one.

The "interchange" argument is typical of the numerous factual distortions which appear in both respondent's and Local 193's briefs. For instance, Michelleti was not the union representative, but rather

ne of Hob Nob's executives, and he flatly denied naking the statement attributed to him. (Brief for NLRB, p. 6; Tr. 272, 274.) Barnum found other mployment before the alleged call to his wife from Villiam Young, not after it. (Brief for NLRB, p. 8; 'r. 212.)

CONCLUSION

For the reasons set forth herein and in petitioner's pening brief, the NLRB Decision and Order should e reversed and set aside.

Dated, Coalinga, California,
September 20, 1966.

Respectfully submitted,
Frame & Courtney,
Ted R. Frame,
Attorneys for Petitioner.

Certificate of Counsel

I certify that, in connection with the preparation f this brief, I have examined Rules 18 and 19 of the Jnited States Court of Appeals for the Ninth Circuit, nd that, in my opinion, the foregoing brief is in full ompliance with those rules.

Ted R. Frame,
Attorney for Petitioner.

No. 20,827

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

K. B. & J. Young's Super Markets, Inc.,

Petitioner,

vs.

National Labor Relations Board,

Respondent.

BRIEF FOR INTERVENOR BUTCHERS UNION LOCAL 193, AFL-CIO.

Charles M. Arak,
629 South Hill Street,
Suite 715,
Los Angeles, Calif. 90014,
Attorney for Intervenor.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.
46

TOPICAL INDEX

Page

Jurisdictional statement 1

Statues involved 1

Issues 2

Argument 3

I.

Petitioner succeeded to its predecessor owner, Kelley's obligation to recognize and bargain with the union; and petitioner's refusal to-recognize the union's contract with Kelley's markets was in violation of Section 8(a)(5) and (1) 1

II.

Petitioner violated Section 8(a)(3) by causing the discharge of all of the meat department employees of the three former Kelley stores and by refusing to employ these former Kelley employees 8

III.

Petitioner violated Section 8(a)(1) and (3) by refusing employment to Newton and by discharging employees Baldwin and Brewton 10

IV.

Petitioner and Jack Young's super market is a single employer within the meaning of the Act .. 13

Conclusion 15

Appendix—Table of Exhibits ..... App. p. 1

TABLE OF AUTHORITIES CITED

Cases	Page
Brooks v. N.L.R.B., 348 U.S. 96, 27 Labor Cases 68,835 (1954)	5
Colony Materials, Inc., 130 N.L.R.B. 105, 47 L.R.R.M. 1248	5
Daniel Crean and Joseph Messore, 139 N.L.R.B. 73, 51 L.R.R.M. 1272	8, 10
Johnson Ready Mix Co., 142 N.L.R.B. 437, 53 L.R.R.M. 1068	4
Joy Silk Mills, Inc., 85 N.L.R.B. 1263, 24 L.R.R.M. 1548, 185 F. 2d 732 (1950)	6
Krantz Wire and Mfg., 97 N.L.R.B. 971, 29 L.R.R.M. 1191	4
L. G. Everist, Inc., 142 N.L.R.B. 193, 53 L.R.R.M. 1017	12
National Labor Relations Board v. Alamo White Truck Service, 273 F. 2d 238 (C.A. 5, 1959)	5
National Labor Relations Board v. Armato, 199 F. 2d 800	4
National Labor Relations Board v. Auto Ventshade, Inc., 39 Labor Cases 66,374	5
National Labor Relations Board v. Lunder Shoe Corp., 25 Labor Cases 68,233, 211 F. 2d 284 (1954)	5
National Labor Relations Board v. Mackay Radio and Telegraph Co., 304 U.S. 333	13
New England Web, Inc., 135 N.L.R.B. 1019, 49 L.R.R.M. 1620	6
Northern California Chapter AGC, 119 N.L.R.B. 1026, 41 L.R.R.M. 1209	10
Northwest Glove Co., Inc., 74 N.L.R.B. 1697, 20 L.R.R.M. 1300	4

Page

Piasecki Aircraft Corp., 123 N.L.R.B. 348, 280 F. 2d 575 (1960) 6

Randolph Rubber Co., 152 N.L.R.B. No. 46 (1965) 5

Redwing Carriers, Inc., 137 N.L.R.B. 1545, 50 L.R.R.M. 1440 12

Tidelands Marine Service, 140 N.L.R.B. 288, 52 L.R.R.M. 1005 10

Wackenhut Corp. v. United Plant Guard Workers, 332 F. 2d 954 (C.A. 9, 1964) 5, 7

Wiley, Inc. v. Livingston, 376 U.S. 543, 84 S. Ct. 909 (1964) 5, 7

Statutes

National Labor Relations Act, Sec. 7 (29 U.S.C. Sec. 157) 1

National Labor Relations Act, Sec. 8(a) (29 U.S.C. Sec. 158(a)) 2

National Labor Relations Act, Sec. 8(a)(1) ....2, 3, 7 .... 10, 13

National Labor Relations Act, Sec. 8(a)(3) ..2, 8, 10, 13

National Labor Relations Act, Sec. 8(a)(5) ..2, 3, 6, 7

National Labor Relations Act, Sec. 9(a) 2

National Labor Relations Act, Sec. 10(e) (29 U.S.C. Sec. 160(e) et seq.) 1

National Labor Relations Act, Sec. 10(f) 1

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NATIONAL LABOR RELATIONS BOARD,

Respondent.

BRIEF FOR INTERVENOR BUTCHERS UNION LOCAL 193, AFL-CIO.

Jurisdictional Statement.

Jurisdiction of this Court rests upon Sections 10(e) and 10(f) of the National Labor Relations Act (29 U.S.C. § 160(e), *et seq.*).

Intervenor appears pursuant to order of this Court filed on April 22, 1966, granting Intervenor's motion to appear herein.

Statutes Involved.

Section 7 of the National Labor Relations Act (29 U.S.C. § 157):

> "Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of

such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8(a)(3)."

Section 8(a) of the Act (29 U.S.C. § 158(a)):

"it shall be an unfair labor practice for an employer—

(1) To interfere with, restrain, or coerce employees in the exercise of rights guaranteed in section 7;"

"(3) By discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization . . ."

"(5) To refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 9(a)."

Issues.

1. Did the Petitioner succeed to its predecessor owner, Kelley's obligation to recognize and bargain with the Union; and did Petitioner's refusal to recognize the Union's contract with Kelley's Markets violate Section 8(a)(5) and (1)?

2. Did the Petitioner violate Section 8(a)(3) by causing the discharge of all of the meat department employees of the three former Kelley stores and refusing to employ former Kelley employees?

3. Did Petitioner violate Section 8(a)(1) and (3) by refusing employment to Newton and by discharging employees Baldwin and Brewton?

4. Is Petitioner and Jack Young's Super Market a single employer within the meaning of the Act?

ARGUMENT.

I.

Petitioner Succeeded to Its Predecessor Owner, Kelley's Obligation to Recognize and Bargain With the Union; and Petitioner's Refusal to Recognize the Union's Contract With Kelley's Markets Was in Violation of Section 8(a)(5) and (1).

Petitioner purchased the three Kelley stores, inventory, and good will [Tr. p. 255], acquired the lease by assignment, understood the operation of the same business at the same location, using substantially the same equipment. [Tr. pp. 328-329.] For a short period of time Petitioner operated under Kelley's name. [Tr. pp. 19, 92-94.]

It was the intention of Petitioner when it purchased the market that it would be "a non-union market". [Tr. p. 136.]

Petitioner in purchasing Kelley's Market knew that there was a Union contract in existence [Tr. pp. 251, 350]; and that while not an actual condition of sale, it was understood that all employees of Kelley's would be terminated as part of the sale. [Tr. pp. 252-253.]

Petitioner had informed Kelley's representatives "That they were not going to honor the Butchers collective bargaining agreement". [Tr. pp. 28-29.]

The collective bargaining agreement in effect between the Union and Kelley's Markets would have expired on January 15, 1965. [Tr. p. 30.] Notice of the purchase by Petitioner of Kelley's was received by the Union on April 21, 1964. [Tr. pp. 26-27.]

There was no substantial change in the method of operation or the kind of merchandise that was sold by Petitioner and the market remained a "super market". [Tr. p. 70.]

The Union, through Mr. Hodson, did request and demand recognition of its contract [Tr. p. 54], and this was for recognition of the existing contract with Kelley which contained the successor ownership clause. [Tr. p. 87.]

It has been consistently held that where there is substantial continuity in the "employing industry", the "successor" must assume the obligation of its predecessor to bargain with the Union representing the employees; in this connection factors to be considered are: was there a substantial continuation of the same business operation, was the same plant used, were the same persons or work force employed, were the supervisory personnel the same, was the machinery, equipment and methods of production the same, and were the same products and services sold and performed; and was the same name retained.

See,

Northwest Glove Co., Inc., 74 N.L.R.B. 1697, 20 L.R.R.M. 1300;

Krantz Wire and Mfg., 97 N.L.R.B. 971, 29 L.R.R.M. 1191;

National Labor Relations Board v. Armato, 199 F. 2d 800;

Johnson Ready Mix Co., 142 N.L.R.B. 437, 53 L.R.R.M. 1068.

If sufficient of the above factors exist, the successor has been held obligated to bargain with the Union on

request, even though the sale specifically excluded an assumption of the obligations of an existing collective bargaining agreement.

Randolph Rubber Co., 152 N.L.R.B. 46 (1965);

Colony Materials, Inc., 130 N.L.R.B. 105, 47 L.R.R.M. 1248.

See also

National Labor Relations Board v. Lunder Shoe Corp., 25 Labor Cases 68,233, 211 F. 2d 284 (1954);

Wackenhut Corp. v. United Plant Guard Workers, 332 F. 2d 954 (C.A. 9, 1964).

In *National Labor Relations Board v. Alamo White Truck Service,* 273 F. 2d 238 (C.A. 5, 1959) the Court held that a successor owner is bound by the terms and conditions of the collective bargaining agreement entered into by its predecessor, in the absence of unusual circumstances—the unusual circumstances were that the various tests of successorship were not met in this case and the Court would not hold two individuals who were conducting a sales and service agency as the successor to the White Truck Company who designs, manufactures and sells motor trucks.

Cf.,

Brooks v. N.L.R.B., 348 U.S. 96, 27 Labor Case 68,835 (1954);

National Labor Relations Board v. Auto Ventshade, Inc., 39 Labor Cases 66,374;

Wiley, Inc. v. Livingston, 376 U.S. 543, 84 S. Ct. 909 (1964).

While Petitioner did not employ a majority of the predecessor's former employees, it did cause the discriminatory discharge of all such employees. Under such

circumstances, there was a sufficient continuity of employment and, the "employing industry" remained essentially the same. Petitioner, by refusing to recognize and bargain with the Union, violated Section 8(a)(5) of the Act.

> *Piasecki Aircraft Corp.*, 123 N.L.R.B. 348, 280 F. 2d 575 (1960);
>
> *New England Web, Inc.*, 153 N.L.R.B. 1019, 49 *L.R.R.M. 1620.*

With regard to the Union's request for recognition, each time recognition was requested, it was denied by principals of Petitioner. [Tr. pp. 32, 67.]

This request or demand for recognition was really a demand for recognition of the contract in existence between the Union and Petitioner's predecessor, Kelley's. [Tr. p. 87.]

In any event, whether it was a demand for recognition by Petitioner, or a demand for recognition by Petitioner as the successor to a previously existing contract, is of no consequence, since Jack Young's, and Petitioner are deemed to be a single employer, and a demand for recognition and bargaining upon either is a demand for recognition and bargaining upon both.

In a letter Petitioner denied the Union recognition, because it claimed to have a good faith doubt of the Union's majority. [General Counsel's Ex. 3.]

The Petitioner's claimed "good faith doubt" as to the Union's majority, or representative status, was in fact based upon Petitioner's unlawful conduct, the discharge of all employees. Its refusal to recognize and bargain with the Union was not in good faith.

> *Joy Silk Mills, Inc.*, 85 N.L.R.B. 1263, 24 L.R.R.M. 1548, 185 F. 2d 732 (1950).

Under the circumstances there was sufficient demand for bargaining in an appropriate unit to support the finding that Petitioner's refusal to recognize and bargain with the Union was in violation of Section 8(a)(5) of the Act.

Further, the sale of Kelley's stores to Petitioner did not automatically terminate Kelley's contract with the Union, and Petitioner was required to honor such contract. By its refusal so to do, Petitioner is in violation of Section 8(a)(1) and (5) of the Act.

> *Wiley, Inc. v. Livingston,* 376 U.S. 543, 84 S. Ct. 909 (1964);
>
> *Wackenhut Corp. v. United Plant Guard Workers,* 332 F. 2d 954 (C.A. 9, 1964).

Petitioner's theory that it is a "small non-unionized firm" and therefore not a successor within the meaning of the Act, because it purchased from a "large unionized firm", is without basis in fact or in law.

(a) Factually Petitioner is of sufficient size to be subject to the jurisdiction of the N.L.R.B., and being subject to such jurisdiction it is bound by the rules of law set forth in N.L.R.B. and court decisions governing successor owners.

(b) Under these cases, the true test is not "a small non-unionized firm" versus "a large unionized firm", but on the contrary these cases hold that size alone is not the determining factor.

The test of whether a purchaser of a business succeeds to the obligations of a union contract of its predecessor is as set forth in this section *supra.*

II.

Petitioner Violated Section 8(a)(3) by Causing the Discharge of All of the Meat Department Employees of the Three Former Kelley Stores and by Refusing to Employ These Former Kelley Employees.

Petitioner, prior to sale, demanded of Kelley's that it discharge all of its employees, including meat department employees. [Tr. pp. 246, 354.]

After Petitioner commenced operation of the Kelley stores, former employees applied for jobs in the meat department; Hart, who had six years seniority, was told he must apply as a new employee [Tr. p. 134], and the supervisor of the meat department, Cleo Thompson, told him the store would be non-Union. [Tr. p. 136.] Hinds and Turner, former employees in the meat department, were told Petitioner had all of the butchers it needed. [Tr. p. 146.]

Barnum was informed in a conversation between William Young and Barnum's wife that a requirement of employment was that Barnum withdraw from the Union. [Tr. p. 219.] Further, Barnum was told by Cleo Thompson that if he wished to work for Petitioner, he would have to get out of the Union. [Tr. pp. 209-210.]

The conduct of Petitioner, in making as a condition of hire of former Kelley meat department employees their withdrawal from the Union, is obviously in violation of Section 8(a)(3).

Daniel Crean and Joseph Messore, 139 n.l.r.b. 73, 51 L.R.R.M. 1272.

It is further evident that Petitioner was determined to operate its meat department using only non-Union employees, based upon its conduct concerning the transfers of employees Brewton and Pappin, who were told they were being transferred so that they would not have to join the Union [Tr. pp. 102-103]; and by its policy of informing ex-employees of Kelley's, Turner and Hinds, that Petitioner had all of the meat department employees it needed, while at the same time it was attempting to hire new employees.

Nor is there any basis in fact for the discharge of Kelley's employees because of observed inefficiencies; the witness Young admits he observed no such inefficiencies in the meat department. [Tr. p. 319.] The witness Charles Young contends that he relied upon his ability to (determine efficiency) "tell by looking at a person whether they are active or inactive". [Tr. p. 345.]

It is of interest to note that the same "inefficient employees" were all offered employment conditioned on (1) their commencement with Petitioner as *new* employees, and (2) their withdrawal from the Union or their acceptance of a non-Union market as an employer. Obviously the alleged inefficient employees immediately upon becoming new employees who disavowed Union membership became sufficiently efficient to be employable by the Petitioner.

It is obvious that Petitioner required Kelley's to discharge its meat department employees as part of a preconceived and calculated plan in an attempt to avoid Petitioner's obligation to recognize and bargain with the Union with respect to the operation of the stores newly acquired by them from Kelley.

Where a purchaser-employer, to evade an existing collective bargaining agreement, requires the termination by the seller of all of its employees, that purchaser has caused the discriminatory discharge of the employees and is in violation of Section 8(1)(3) of the Act.

> *Northern California Chapter AGC,* 119 N.L.R.B. 1026, 41 L.R.R.M. 1209.

Further, it would have been, under these circumstances, futile for other discharged employees who did not do so, to make known to Petitioner their availability for work.

> *Tidelands Marine Service,* 140 N.L.R.B. 288, 55 L.R.R.M. 1005.

III.

Petitioner Violated Section 8(a)(1) and (3) by Refusing Employment to Newton and by Discharging Employees Baldwin and Brewton.

Newton telephoned Young and was informed by him that Petitioner had its own union [Tr. p. 222] and that she should get a withdrawal card from the Union. [Tr. pp. 222, 224.] When Newton told Young that she couldn't work without a union he withdrew his offer of employment. [Tr. pp. 223-224.]

This conduct is in violation of Section 8(a)(3).

> *Daniel Crean and Joseph Messore,* 139 N.L.R.B. 73, 51 L.R.R.M. 1272.

About the first of June, Jack Baldwin, who had been employed at Brundage Lane since February, 1964 [Tr. p. 152], was transferred to Petitioner's Chester Avenue store after Baldwin indicated that he wouldn't cross the

picket line. [Tr. pp. 153, 155, 180.] After Baldwin had worked at the Chester store for two or three weeks, Bill Sing, store manager, asked him if he belonged to the Union and when Baldwin replied that he did, asked why. [Tr. pp. 156-157.] Baldwin also testified that several times he heard William Young mutter, "I don't know why you fellows need to belong to the Union anyhow." [Tr. p. 155.]

Just before his vacation, Baldwin had a conversation with William Young which gave him the impression that he wouldn't have a job when he returned from his vacation. When he mentioned these doubts to Young, Young assured him that his job was secure. However, on about August 31, 1964, the day before Baldwin was to report to work, Bill Young telephoned him and told him that business was slow and he was not needed anymore. [Tr. pp. 157-158, 194-195.] Petitioner contends that Baldwin was discharged because business was slow and he was inefficient in his new job as meat manager. [Tr. p. 196.]

Baldwin was replaced by Jerry Mundshau. [Tr. pp. 118-119.]

Young, however, considered Baldwin to be a fairly decent meat cutter [Tr. p. 312], but Baldwin was discharged and an apprentice meat cutter retained. [Tr. p. 379.]

Brewton testified that on about June 13, 1964, meat supervisor Thompson told her that he wanted to transfer her back to the Brundage store and transfer employee Pappin, then working at Brundage, to Roberts Lane, so that Pappin would not have to join the Union. [Tr. pp. 102-103.] When Brewton protested crossing the picket line, Thompson said if she refused to cross

the picket line and lost her job did she think the Union would get her another job [Tr. p. 103] and further told her to make up her mind whose side she was on, Young's or the Unions. [Tr. p. 103.] Later when Brewton definitely stated that she would not cross the picket line, Thompson discharged Brewton stating, "Well, we will mail you your check then."

William Young and Thompson contend that Brewton was discharged because business was slow and Brewton was inefficient; but she was efficient enough to work at the Brundage store. [Tr. p. 328.] Admittedly, however, Brewton was immediately replaced by Charlene Pappin, who was transferred from the Brundage Lane store. [Tr. pp. 397, 407.]

Petitioner's explanation of its reason for Brewton's transfer and discharge does not withstand scrutiny. In view of the fact that the Union demanded that Pappin join the Union, and Thompson's statements to Brewton about not wanting Pappin to have to join the Union, it is apparent that Petitioner's attempt to transfer Brewton to the Brundage store was, in fact, based on her union loyalties and was motivated by Petitioner's desire to frustrate the operation of the existing union-security agreement at the Brundage store.

Brewton's subsequent discharge for refusing to cross the picket line was directly based on union considerations and, as such, violative of Section 8(a)(3) of the Act.

Brewton's unwillingness to cross the picket line constituted concerted protected activity. *Cf., Redwing Carriers, Inc.*, 137 N.L.R.B. 1545, 50 L.R.R.M. 1440; *L. G. Everist, Inc.*, 142 N.L.R.B. 193, 53 L.R.R.M. 1017. Petitioner cannot argue that, in the interest of

continuing the efficient operation of its business, it could legally replace Brewton since Petitioner, by its attempted unlawful transfer of Brewton, placed her in the position of having to choose whether or not to cross the picket line. *Cf. National Labor Relations Board v. Mackay Radio and Telegraph Co.*, 304 U.S. 333.

Petitioner's alleged reason for discharging Baldwin does not withstand scrutiny. The issue of Baldwin's alleged inefficiency as a head meat cutter, a job he had held for less than a month before his vacation and subsequent discharge, was raised for the first time at the trial, and Petitioner's contention that business was slow is negated by Petitioner's Exhibit 7. In view of this, and against the background of Petitioner's union animus as evidenced by its conduct outlined above and Young's conversation with Baldwin immediately prior to Baldwin's vacation, Baldwin's discharge was violative of Section 8(a)(1) and (3) of the Act.

IV.

Petitioner and Jack Young's Super Market Is a Single Employer Within the Meaning of the Act.

Jack Young's Markets and Petitioner in truth and in fact is one operation. The separate corporate entities may be of significance to the owners, for tax, or other purposes, but insofar as the obligations of those corporations are related to the employees in the various markets, the legal guise of separate entities, and of two corporations, must be pierced and the substance of the market operation must govern.

Looking to its substance it is obvious that Petitioner and Jack Young's Markets are one and the same, and represent a single employer under the Act.

The transcript of the original proceedings before the N.L.R.B. Hearing Officer contains numerous statements that show beyond question that the two corporations are in fact a single employer, and that many persons had dual positions, working for both corporations.

(1) There were numerous exchanges of employees between Jack Young's Markets and K B & J, Petitioner herein. Those interchanges of employees were at the instance and request of the employer. [Tr. pp. 56-58.]

(2) Numerous employees were involved in these transfers:

Oscar Johnson [Tr. p. 59]
Carlos Perez [Tr. p. 59]
Dorothy Hill [Tr. pp. 59-60]
Jack Baldwin [Tr. pp. 60, 163]
Imogene Brewton [Tr .pp. 60, 94-95]
Jerry Mulhauser [Tr. p. 60]
Charlene Pappin [Tr. p. 61]
Dean Smith [Tr. p. 61]
Pat Huggin [Tr. p. 61]
Cleo Thompson [Tr. pp. 63-64]
Bill Sing [Tr. p. 265]

(3) That employees working at Petitioner's market, or at the Young's markets, were paid in separate checks for work at each separate store, but all of the checks had printed on them Young's Market. [Tr. pp. 96-97, 100-101, 164.] These check stubs are in evidence as General Counsel's Exhibit 13(b) and 14(a), (b), (c).

(4) Management and supervision of Petitioner's market and Jack Young's Markets were in many instances one and the same:

Bill Young was the "boss" at K B & J, and also at Jack Young's Markets. [Tr. p. 195.]

Cleo Thompson was the supervisor "over all the meat departments" (K B & J and Young's Market). [Tr. pp. 198-200, 335.]

Kenneth Roderick, supervisor of K B & J, when needed could be located at one of several of Young's Markets. [Tr. pp. 263, 270.]

William Young testified that he had authority to move people between Petitioner and Jack Young's Markets because "I have a dual job". [Tr. pp. 304-305.]

The bookkeeper for K B & J had an office at, and worked at the Jack Young's store in Visalia. [Tr. p. 341.]

(5) Ordering of meats and supplies for both companies was done by either company [Tr. pp. 175-176] and meat was transferred from one company's stores to the other company's stores with or without billing. [Tr. p. 333.]

Conclusion.

For the reasons set forth herein, the N.L.R.B. Decision and Order should not be reversed, and should remain in full force and effect, and the parties thereto should be ordered to comply with said Decision and Order.

Dated at Los Angeles, California, August 19, 1966.

Respectfully submitted,

Charles M. Arak,
Attorney for Intervenor.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Charles M. Arak,

APPENDIX.

Table of Exhibits.

Exhibit	Identification	In Evidence
General Counsel's:		
1(a)-1(y) (formal documents)	Tr. 5	Tr. 5
2 (collective bargaining agreements)	11	12
3 (letter, Specht to Hodson)	12	13
4 (letter, Hodson to Specht)	13	13
5 (letter, Frame to Hodson)	14	14
6 (letter, Hodson to petitioner)	15	15
7 (letter, Frame to Hodson)	15	15
8 (letter, Arak to petitioner)	15	16
9 (letter, Frame to Arak)	16	16
10 (contract of sale)	17	17
11(a)-(b) (Brewton paychecks)	97	99
12(a)-(b) (Brewton paychecks)	97	99
13(a)-(b) (Baldwin paychecks)	98	100
14(a)-(c) (Baldwin paychecks)	164	165
Petitioner's:		
1 (Representation petition)	20	20
2 (letter, Scully to Frame)	20	20
3 (letter, Hob Nob to Union)	73	73
4 (Brewton paychecks)	124	124
5 (Brewton paychecks)	125	125
6 (Brewton paychecks)	125	125
7 (sales volume record)	302	303
8 (list of employees)	302	
Union's:		
1 (newspaper ad)	69	69

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 20827

K. B. & J. YOUNG'S SUPER MARKETS, INC., Petitioner

v.

NATIONAL LABOR RELATIONS BOARD, Respondent

SUPPLEMENT TO BRIEF ON BEHALF OF INTERVENOR -

BUTCHERS UNION LOCAL 193, AFL-CIO

CHARLES [illegible]
629 So. Hill St.
Los Angeles, Calif. [illegible]

Attorney for Intervenor
Butchers Union Local 193,
AFL-CIO

The case discussed herein was decided, and the opinion therein released, after Intervenor's brief was filed in this case.

Accordingly, request is respectfully made that this Supplement to Brief for Intervenor Butchers Union Local 193, AFL-CIO, be filed as part of its brief previous submitted to the Court.

Dated: Sept. 23, 1966

Respectfully submitted

CHARLES M. ARAK, Attorney
Intervenor Butchers Union
Local 193, AFL-CIO

PETITIONER SUCCEEDED TO ITS PREDECESSOR OWNER'S UNION CONTRACT

Despite a purchaser's specific disavowal of any agreements that its seller may have had with other parties, a Federal Trial Court has ordered the purchaser to recognize and give effect to the seller's collective bargaining contract.

The purchaser required included in the contract of sale a provision requiring the seller to discharge all of his employees and to close the plant prior to the completion of the sale. The sale contract further provided that purchaser would not assume seller's employment contracts, union contracts, or any liability for accrued fringe benefits.

Purchaser took possession of the plant, and hired his own employees, many of them being former employees at the plant.

The Court held that the plant was essentially the same. Identical products were manufactured. Employees were essentially the same as those employed by the seller. Therefore the common law of the shop prevailing under the seller survived the transfer of ownership, and the Court ordered the purchaser to honor the collective bargaining agreement which the seller had signed. Pulp, Sulphite & Paper Mill Workers v. Great No. West Fibre Co., D.C. Wash. 1966; 54 L.C. Section 11,412

PROOF OF SERVICE BY MAIL

I certify or declare under penalty of perjury as provided by CCP 2015.5 that on September 23, 1966, I served the within Supplement to Brief on Behalf of Intervenor Butchers Union Local 193, AFL-CIO, on petitioner and respondent by placing a true copy thereof enclosed in sealed envelopes with postage thereon fully prepaid, in the United States Post Office mail box at Los Angeles, California, addressed as follows:

Marcel Mallet-Prevost
Assistant General Counsel
National Labor Relations Board
Washington 25, D.C.

Ted R. Frame
Frame & Courtney
P.O.Box 895
Coalinga, Calif.

Dated at Los Angeles, California, September 23, 1966.

Joyce Pechenpaugh

No. 20,841

IN THE

United States Court of Appeals
For the Ninth Circuit

In the Matter of
DESERT DIET DEVELOPMENT CORPORATION,
Debtor.

DESERT DIET DEVELOPMENT CORPORATION,
Appellant,

vs.

CHARLES W. HERBERT, WALTER T. MOLL, and MELVIN HELLWITZ,
Appellees.

On Appeal from the United States District Court for the District of Arizona

OPENING BRIEF FOR APPELLANT

CLAGUE A. VAN SLYKE,
182 North Court Street,
Tucson, Arizona 85701,
Attorney for Appellant.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO, CALIFORNIA

Subject Index

	Page
Jurisdictional statement	1
Introduction	1
Statement of the case	2
Facts of this case	2
Statutes involved	5
Specification of errors relied upon	5
Questions presented	6
Argument I	6
Argument II	9
Conclusion	19

Table of Authorities Cited

Cases

Pages

In re General Stores Corporation, 129 F. Supp. 801, aff'd 222 F. 2d 234 (2d Cir. 1955), 76 S. Ct. 516 8

In re Herold Radio & Electronics Corporation, 191 F. Supp. 780 11

In re Philadelphia Rapid Transit Company (District Court of Pennsylvania) 8 F. Supp. 51 8

In re Transvision, Inc., 119 F. Supp. 134, aff'd 217 F. 2d 243 (2d Cir. 1954) 8, 9

Securities and Exchange Commission v. American Trailer Rentals Co., 85 S. Ct. 513, 379 U.S. 594 (1965) 8, 10

Securities and Exchange Commission v. Crumpton Builders, Inc., 337 F. 2d 907 11

Securities and Exchange Commission v. United States Realty and Improvement Co., 310 U.S. 434 (1940), reversing 108 F. 2d 794 .... 8, 10

Statutes

United States Bankruptcy Act, 11 U.S.C.A.:

- Chapter X .... passim
- Chapter XI .... passim
- Section 24, Paragraph 47 1
- Section 121 (11 U.S.C.A. 521) 1
- Section 130(7) 5
- Section 141 5
- Section 143 5
- Section 145 5
- Section 146(2) 5

Miscellaneous

Journal of the National Conference of Referees in Bankruptcy, January, 1956 8

No. 20,841

IN THE

United States Court of Appeals

For the Ninth Circuit

In the Matter of DESERT DIET DEVELOPMENT CORPORATION, Debtor.	
DESERT DIET DEVELOPMENT CORPORATION, *Appellant,* vs. CHARLES W. HERBERT, WALTER T. MOLL, and MELVIN HELLWITZ, *Appellees.*	

On Appeal from the United States District Court for the District of Arizona

OPENING BRIEF FOR APPELLANT

JURISDICTIONAL STATEMENT

This is an appeal from an order entered November 10, 1965, by the United States District Court for the District of Arizona. This appeal is brought under the jurisdiction established by Section 24 of the Bankruptcy Act, 11 U.S.C.A., paragraph 47, and Section 121 of the Bankruptcy Act, 11 U.S.C.A. 521.

INTRODUCTION

For the sake of brevity, Desert Diet Development Corporation will hereinafter be referred to as the

"Debtor", and Charles W. Herbert, Walter T. Moll, and Melvin Hellwitz will be referred to collectively as the "Petitioners".

The Transcript of Record will be designated "T.R.", and the Reporter's Transcript will be designated "R.T."

STATEMENT OF THE CASE

This case is concerned with the order of the Referee in Bankruptcy, affirmed by the United States District Judge, which order approved a debtor's petition for an involuntary reorganization of the Debtor corporation under Chapter X of the United States Bankruptcy Act.

It is the contention of the Appellant that the involuntary petition and the facts as presented in the hearings do not entitle the Petitioners to the relief prayed for in their petition, and that the order approving the petition is a misapplication of Chapter X of the Bankruptcy Act.

FACTS OF THIS CASE

Desert Diet Development Corporation is a corporation organized under the laws of the State of Florida, licensed to carry on business in the State of Arizona.

Each of the three Petitioners is a creditor of said corporation who has a claim against the corporation or its property and each of said claims is liquidated as to amount and not contingent as to liability, which

claims arise from the sale of land to the Petitioners. The claims of the said Petitioners amount in the aggregate to more than $5,000.00.

The unsecured debts of the Debtor total approximately $567,000.00. The secured debts total approximately $174,000.00, giving a total corporate debt of approximately $741,000.00. Approximately $300,000.00 of this indebtedness shown above as unsecured indebtedness arises from the sale of lots, and a substantial proportion of this indebtedness could be satisfied by the conveyance of the lots.

The assets of the corporation consist of real property, accounts receivable due to the corporation pursuant to contracts for the sale of lots, engineering expenses and development costs. As raw land, the land of the corporation has a value of from $300 to $600 per acre. From all of the evidence in the case, it appears that the land as raw land has a probable value of approximately $500 per acre. A great deal of the engineering work has been completed with respect to the subdividing of certain lands, and, not including lands which are the subject of existing contracts for sale, there are more than 2,750 lots available for development and sale. These lots have a reasonable prospect of development and sale, which according to conservative estimates as to development costs and sales promotion, should yield a net return of at least $400 per lot.

The Debtor corporation is and was at the time of the filing of the original petition herein unable to meet its debts as they mature.

That a proceeding to foreclose a mortgage against all or the greater portion of the property of the Debtor corporation is now pending in the Superior Court of Santa Cruz County, Arizona, said proceeding being Civil Action No. 5584 in that Court. The Petitioners are members of a syndicate group which holds the mortgage after purchasing it from a third party.

The balance sheet of the corporation dated May 1, 1963, Exhibit 14 in evidence, does not indicate how many shares of capital stock, if any, have been issued. There are three stockholders in the corporation. (See page 3, paragraph 8 of verified answer, T.R. page 15, Vol. 1.)

Members of the syndicate which holds the mortgage have agreed to subordinate the first mortgage and to issue deeds to lot purchasers. That since the filing of the petition the Debtor corporation has delivered to the Court-appointed trustee deeds to all property purchased, not only by the three Petitioners, but by the approximately two hundred other persons purchasing lots in Buena Vista.

The assets of the corporation have a value exceeding the liabilities of the corporation, and if the affairs of the corporation were managed and administered on a businesslike basis, there is a fair prospect that the corporation could pay its debts and realize a profit for its investors.

The following are proceedings now pending affecting the property of the corporation:

(a) There is now pending against the corporation a suit for the foreclosure of a first mort-

gage upon all of its land, said suit being Civil Action No. 5584 in the Superior Court of Santa Cruz County, Arizona.

(b) There is now pending a class action for declaratory judgment filed by five syndicate investors on behalf of all the syndicate investors seeking a declaration of the rights of the syndicate investors and seeking to have the assets of the corporation applied to the discharge of the debts of the corporation and the profits, if any, from the operation distributed in accordance with law. Said civil action is Action No. 5708 now pending in the Superior Court of Santa Cruz County, Arizona.

There is no pending plan of reorganization, readjustment, or liquidation affecting the property of the corporation, either in connection with or without any judicial proceedings.

STATUTES INVOLVED

United States Bankruptcy Act: Sections 130(7), 141, 143, 145, and 146(2).

SPECIFICATION OF ERRORS RELIED UPON

The Court erred in its application of Chapter X of the Bankruptcy Act in two instances; namely, (1) "Adequate relief" is available under Chapter XI of the Bankruptcy Act, and (2) the corporate structure of the Debtor and the classification of the credi-

tors is simple, and there should be no reason for an alteration of the relationship of the creditors to the Debtor.

QUESTIONS PRESENTED

1. Does a mortgage foreclosure as joined in by the Petitioners, a suit for declaratory relief and accounting joined in by the Petitioners, and the delivery of deeds by the Debtor to all purchasers, and the rights of the Debtor under Chapter XI provide "adequate relief" to the Petitioners, and therefore demand proof before the Referee of a type and nature not submitted to the Referee in this case?

2. Does a corporation with three stockholders, \$567,000.00 in unsecured debts (\$300,000.00 of which has been satisfied by the delivery of deeds), a \$150,000.00 first mortgage, and \$300,000.00 in syndicate holders meet the sophisticated requirements for a Chapter X Arrangement?

ARGUMENT I

The Referee in Bankruptcy in Finding of Fact No. 13, page 5 of the "Report of Special Master on Issues", R.T. Volume I, page 45, and further in Conclusion of Law No. 3, states: "The Petitioners do not have adequate relief." These findings were confirmed by the District Judge without additional comment.

First, the Referee states that the mortgage foreclosure did not give adequate relief as it would

destroy the rights of "creditors" and "investors". The missing consideration is obvious. The mortgage is owned in part by the Petitioners. T.R. Volume 3, page 99. (Also see Petitioners' Exhibit No. 8.) The syndicate investors are also holders of the mortgage and are also Petitioners. Secondly, the Court states that the suit for declaratory relief can give no adequate relief to Petitioners as "creditors". The Petitioners are "creditors" because they purchased property from the Debtor corporation.

The deeds to these properties have been delivered to the Trustee on October 8, 1965. The record shows that as creditors this extinguishes the claim of the Petitioners, and full relief has been given to them.

The issue of adequate relief has been discussed extensively in many cases and in *Law Review* articles. Ordinarily this applies to an argument between relief under Chapter X and Chapter XI of the Bankruptcy Act where the debtor or certain of its creditors have requested relief under Chapter XI, and other creditors, but not the debtor, have sought relief under Chapter X.

It is submitted that the basis of this argument is that even though the Debtor in this case has not requested relief under Chapter XI of the Bankruptcy Act, that the same tests and requisites of proof apply to the petition of the three creditors in this case before the remedies of Chapter X can be available.

On the Debtor's motion to dismiss the involuntary petition, the question is not whether the items of ade-

quate relief was properly pleaded by the Petitioners, but whether the Petitioners proved that they needed the use of Chapter X to give them "adequate relief". *In re Philadelphia Rapid Transit Company,* District Court of Pennsylvania, 8 F. Supp. 51.

The *Journal of the National Conference of Referees in Bankruptcy,* January, 1956, contains an extensive article on the conflict between Chapter X and Chapter XI of the Bankruptcy Act where competing petitions were before the Court. This article discusses *In re General Stores Corporation,* 129 F. Supp. 801, aff'd 222 F. 2d 234 (2d Cir. 1955), 76 S.Ct. 516; *In re Transvision, Inc.,* 119 F. Supp. 134, aff'd 217 F. 2d 243 (2d Cir. 1954); and, *Securities and Exchange Commission v. United States Realty and Improvement Co.,* 310 U.S. 434 (1940), reversing 108 F. 2d 794.

In the *General Stores* case and the *United States Realty* case, *supra,* the Supreme Court issues a clear mandate for a case-by-case approach, and states conclusively that there are no absolute rules for the Court to use in determining whether Chapter X of the Bankruptcy Act is applicable to a corporate reorganization.

See *Securities and Exchange Commission v. American Trailer Rentals Co.,* 85 S.Ct. 513, 379 U.S. 594 (1965) at (5). This case states:

> "In enacting these two distinct methods of corporate rehabilitations, Congress has made it quite clear that Chapters X and XI are not alternate routes, the choice of which is in the hands

of the debtor. Rather, they are legally, mutually exclusive paths to attempted financial rehabilitation. A Chapter X petition may not be filed unless 'adequate relief' is not obtainable under Chapter XI, § 146(2). Likewise, a Chapter XI petition is to be dismissed, or in effect transferred, if the proceedings 'should have been brought' under Chapter X, § 328."

In the *Transvision* case, *supra,* at page 246, the Court states that the Bankruptcy Act "Manifests a conscious purpose of Congress to encourage resort to Chapter XI whenever the remedy afforded thereby adequately protects the interests involved."

It is respectfully submitted that the Court below erred when it allowed the petition for a Chapter X Arrangement, because "adequate relief" is available under Chapter XI.

ARGUMENT II

It is the contention of the Appellant, Desert Diet Development Corporation, that Chapter X of the Bankruptcy Act should not be applied to the corporation as the remedy is too drastic, and that the corporation is simply composed with only three stockholders, and that it was never the intention of Congress or the Bankruptcy Act to attempt to reorganize under Chapter X such a simple corporation.

The cases referred to in Argument I discuss generally the types of corporation Chapter X should be applied to. The following authority is presented in support of the Appellant's position.

In *Securities and Exchange Commission v. American Trailer Rentals Co.,* 85 S.Ct. 513, 379 U.S. 594 (1965), the Court discusses the type of corporation to which Chapter X applies. The Court states at page 521 that

> "The one [Chapter X] adapted to the reorganization of corporations with complicated debt structures and many stockholders, the other [Chapter XI] to composition of debts of small individual businesses and corporations with few stockholders".

This citation is from the *United States Realty* case and it was cited with approval where the Court continued that the *United States Realty* case stated that Chapter X is best used where there is a publicly held corporation. This is not the case in Desert Diet Development Corporation with only three stockholders.

Securities and Exchange Commission v. American Trailer Rentals Co., 85 S.Ct. 513, 379 U.S. 594 (1965) at page 522:

> "The Court stated:
>
> > 'It may well be that in most cases where the debtor's securities are publicly held c. X will afford the more appropriate remedy. But that is not necessarily so. A large company with publicly held securities may have as much need for a simple composition of unsecured debts as a smaller company. And there is no reason we can see why c. XI may not serve that end. The essential difference is not between the small company and the large company but between the needs to be served.' 350 U.S. at 466, 76 S.Ct. at 519.

"The Court pointed out that the 'needs to be served' included such factors as requirements of fairness to public debt holders, need for a trustee's evaluation of an accounting from management or determination that new management is necessary, and the need to readjust a complicated debt structure requiring more than a simple composition of unsecured debt. Id., at 466-467, 76 S.Ct. at 519."

In the case of *Securities and Exchange Commission v. Crumpton Builders, Inc.,* 337 F. 2d 907 at page 909, the Court states:

"The jurisdictional scope of Chapters X and XI, both enacted as part of the 1938 Chandler Amendment to the Bankruptcy Act, has perplexed lawyers and judges. Chapter X seems appropriate for a giant corporation with a complex debt and equity structure or for a corporation in dire need of new capital or management; Chapter XI seems appropriate for a small closely held corporation to settle with its trade creditors. But there was no formula in the statute and no guideline in the legislative history."

The Appellant realizes that the cases cited call for a case-by-case decision and that the six leading cases are somewhat confusing as to what type of corporation Chapter X should be applied to. *In re Herold Radio & Electronics Corporation,* 191 F. Supp. 780 at page 784, states:

"In the following cases, Chapter X was preferred to Chapter XI: General Stores Corp. v. Shlensky, supra; Securities and Exchange Com-

mission v. United States Realty & Improvement Co., supra; Securities and Exchange Commission v. Liberty Baking Corporation, supra.

In the following cases, Chapter XI was preferred to Chapter X: Securities and Exchange Commission v. Wilcox-Gay Corp., 6 Cir., 1956, 231 F.2d 859; In Re Transvision, Inc., supra; In re Lea Fabrics, Inc., supra.

The surface alignment of the six leading decisions becomes plastic in the hands of those who, by a process of selective emphasis that disregards context, find statements in the opinions and facts in the records that seemingly can be moulded to fit either side of rival arguments in a particular case.

In reality, these decisions form an harmonious body of law. They suggest a common thesis and a common approach.

In United States Realty & Imp. Co., supra, the Court concluded that the petition for an arrangement of unsecured debts under Chapter XI should be dismissed because the relief obtainable under that chapter was inadequate. The legislative history and the respective policies, purposes and operational procedures of the two chapters were compared and contrasted in Mr. Justice Stone's opinion.

In that case (310 U.S. at page 456, 60 S.Ct. at page 1053), the circumstances were 'such as to raise a serious question whether any fair and equitable arrangement in the best interest of creditors can be effected without some rearrangement of its capital structure.' The Court pointed out (310 U.S. at page 456, 60 S.Ct. at page 1053)

that a Chapter X proceeding would permit an inquiry into the debtor's 'financial condition and practices and its business prospects * * * without which there is at least danger that any adjustment of its indebtedness will not be just and equitable, and that its revived financial life will be too short to serve any public or private interest other than that of respondent [the debtor].'

In General Stores Corp. v. Shlensky, supra, the Court decided that proceedings under Chapter X rather than Chapter XI were appropriate. The Court's opinion (per Mr. Justice Douglas) pointed out (350 U.S. at page 466, 76 S.Ct. at page 519):

> 'The character of the debtor is not the controlling consideration in a choice between c. X and c. XI. Nor is the nature of the capital structure. * * * The essential difference is not between the small company and the large company but between the needs to be served.
>
> 'Readjustment of all or a part of the debts of an insolvent company without sacrifice by the stockholders may violate the fundamental principle of a fair and equitable plan * * * as the United States Realty Co. case emphasizes.
>
> 'Readjustment of the debt structure of a company without more may be inadequate unless there is also an accounting by the management for misdeeds which caused the debacle.
>
> 'Readjustment of the debts may be a minor problem compared with the need for new management. Without a new management today's readjustment may be a temporary moratorium before a major collapse.

> 'These are typical instances where c. X affords a more adequate remedy than c. XI.'

In Securities and Exchange Commission v. Liberty Baking Corporation, supra, the Court concluded (240 F.2d 516) that there were 'important features which call for the application of Chapter X,' rather than Chapter XI. Judge Frank, writing for the Court of Appeals, pointed out (240 F.2d 514):

> 'The proposed arrangement is for more than a "simple composition" of creditors. Not only is considerable amount of Liberty's debentures held by public investors, but the arrangement would seriously disturb their rights.'

The Court also adverted (240 F.2d 515) to 'a grave question whether the plan would deprive creditors of their "absolute priority" rights as against stockholders,' and to the need for determing whether 'a change of management is essential.'

At page 516 of 240 F.2d, footnote 10, Judge Frank distinguished Securities and Exchange Commission v. Wilcox-Gay Corp., supra, and In Re Transvision, Inc., supra, in the following discussion:

> 'In S.E.C. v. Wilcox-Gay Corp., 6 Cir., 231 F.2d 859, it is true that the court, referring to the Supreme Court's decision in General Stores, upheld the exercise of the District Court's discretion to permit Chapter XI proceedings. But there the facts were considerably different from those in the instant case: (1) The debtor had previously undergone Chapter X proceedings, and, following rather extensive investigation of

its affairs in those proceedings, was permitted to go into Chapter XI proceedings after the secured creditors' claims were met in full. (2) The debenture holders (who held securities of about $220,000) received interest payments on their claims, and apparently only general (trade) creditors were included in the scaling down to 50% of their claims. (3) The court rested its decision on the ground that the analytical procedures available under Chapter X had in fact been carried out by the Trustee in the preceding Chapter X proceedings; the court was convinced that there was no need for further independent investigation; and no possible benefit could accrue to the general public, general creditors, or secured creditors by further investigation. Here, on the other hand, we have no such assurance or conviction. (4) Finally, in the Wilcox-Gay case, In re Wilcox-Gay Corp., D.C., 133 F.Supp. 548, 551, the debtor corporations were wholly owned by the creditors of the corporations, and the "outstanding securities of the debtor corporations have no present book value." There has been no testimony to the effect that the securities of the corporation in this case are without book value, and certainly the proposed arrangement here does not contemplate putting the control of the company in the hands of creditors, as did the arrangement in the Wilcox case.

'In re Transvision, Inc., 2 Cir., 217 F.2d 243, certiorari denied S. E. C. v. Transvision, Inc., 348 U.S. 952, 75 S.Ct. 440, 99 L.Ed. 744, involved no disturbance of the creditors' priority rights, and the plan affected trade and com-

mercial creditors only. More important, that decision antedated the Supreme Court's decision in General Stores.'

[10] Just as section 146(2) of Chapter X [11 U.S.C.A. § 546(2)] explicitly provides that that chapter may not be used where 'adequate relief' would be obtainable under Chapter XI, so the United States Realty and General Stores cases hold that Chapter XI may not be resorted to where the relief and procedures available only under Chapter X are more appropriate for the protection of the public and private interests involved.

Chapter XI contains no provisions dealing with the rights of secured creditors or of stockholders and no provisions for notice to such parties of the various steps in the proceeding.

Where a referee confirmed an arrangement altering the rights of secured creditors, the order confirming the arrangement was vacated. In the Matter of Camp Packing Company, D.C.N.D. N.Y., 1956, 146 F.Supp. 935. Similarly, a Chapter XI proceeding was dismissed where it involved a transfer of all of the debtor's assets and affected the rights of stockholders. In re May Oil Burner Corporation, D.C.D.Md. 1941, 38 F.Supp. 516.

[11] In neither Chapter X nor Chapter XI is there any definition or classification that would enable the Court to say 'that a corporation is small or large, its security holdings few or many, or that its securities are "held by the public,"' so as to place the debtor exclusively under one chapter rather than the other. Securities and Exchange Commission v. United States Realty & Improvement Co., supra, 310 U.S. 447, 60 S.Ct.

1049. The question is one of propriety 'in the circumstances,' giving due weight to 'the public policy' of the two chapters, their 'legislative history,' their 'terms,' the comparative powers of the court under the two chapters, and the comparable adequacy of the relief and safeguards available under the two chapters.

[12-23] The problem is not one of absolutes. The approach is not monolithic. It is pluralistic—evaluating the aggregate of circumstances in accordance with the guiding criteria expounded by the Supreme Court. Some of the pertinent questions are, for example: Who should control the administration of the debtor's estate and formulate plans for its rehabilitation? Should the features of speed and economy give way to the considerations of thoroughness and disinterestedness? Is there need for an independent study of the debtor's affairs by court or trustee? Is it desirable that advice be given to creditors with respect to their rights or interests in advance of their consent to a plan or arrangement? Is it appropriate that there be restriction on or supervision over the selection and conduct of creditors' committees? Does the situation call for something more than an arrangement of only the rights of unsecured creditors of the debtor, without alteration of the relations of any other class of security holders? Will effective relief probably entail rearranging the capital structure of the corporation or will it involve only a simple composition of debts with unsecured creditors? Will there be any scaling down of the claims of creditors with or without some fair compensating advantage to them which is prior to the rights of stockholders? Will there probably be some readjustment of the

> rights of stockholders? Is it likely that the stockholders will be eliminated, and can this question be answered with any assurance without resorting to the facilities for investigation of the financial condition and structure of the debtor? Is there a serious question of continuing the present management of the debtor?
>
> The answer to no one single question is necessarily decisive. All of the sample questions suggest the breadth of the field to be canvassed. The breadth of the inquiry forecloses a solution by mechanically applying a rigid formula."

The Court then states we should turn to the particular circumstances of the case at bar. As the Court knows, Desert Diet Development Corporation has three stockholders, many purchasers of real estate, and syndicate holders. The purchasers of real estate have received the relief sought by a delivery of the deeds to the trustee herein. This leaves only the rights of "syndicate investors" to be protected. The "syndicate investors" have filed suits in the State Courts of Arizona. It is therefore the contention of the Appellant that the petition should be dismissed as the corporation and its creditors do not need the relief provided by Chapter X of the Bankruptcy Act.

CONCLUSION

It is respectfully submitted that under Chapter X of the Bankruptcy Act and the cases as submitted, that the Order of the District Judge and of the Referee be set aside and the involuntary petition filed against the corporation be dismissed.

Dated, Tucson, Arizona,
October 12, 1966.

Clague A. Van Slyke,
Attorney for Appellant.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Clague A. Van Slyke.

(Appendix Follows)

Appendix

Appendix

United States Bankruptcy Act:

Section 130. Every petition shall state—

(7) the specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under Chapter XI of this Act.

Section 141. Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.

Section 143. If the answer of a debtor shall controvert any of the material allegations of the petition, the judge shall, as soon as may be, determine, without the intervention of a jury, the issue presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied.

Section 145. If any issue raised in an answer filed under section 136 or 137 of this Act has, after hearing upon notice to the debtor, creditors, indenture trustees, and stockholders entitled to controvert the allegations of the petition, already been tried and finally determined under the provisions of section 143

or 144 of this Act, such final determination shall be conclusive for all purposes under this chapter.

Section 146. Without limiting the generality of the meaning of the term "good faith", a petition shall be deemed not to be filed in good faith if—

(2) adequate relief would be obtainable by a debtor's petition under the provisions of chapter XI of this Act.

No. 20841

In the

United States Court of Appeals

For the Ninth Circuit

DESERT DIET DEVELOPMENT CORP., *Appellant*, vs. CHARLES W. HERBERT, WALTER T. MOLL, and MELVIN HELLWITZ, *Appellees.*	

Appellees' Brief

CHARLES D. MCCARTY
1110 Phoenix Title Building
177 North Church Avenue
Tucson, Arizona
Attorney for Appellees

SORG PRINTING COMPANY OF CALIFORNIA, 346 FIRST STREET, SAN FRANCISCO 94105

SUBJECT INDEX

	Pages
Introduction	1
Supplemental Statement of Facts	2
Answer to Argument I	3
Answer to Argument II	4
Conclusion	11
Appendices	

TABLE OF AUTHORITIES CITED

Cases

Ferguson v. Superior Court, 76 Ariz. 31, 258 P.2d 421 6

General Stores Corp. v. Shlensky (1956), 350 U.S. 462, 76 S.Ct. 516, 100 L.Ed. 550 .... 7, 9

Securities and Exchange Commission v. American Trailer Rentals (1965), 379 U.S. 594, 85 S.Ct. 513, 13 L.Ed.2d 510 7

Reilly v. Clyne, 27 Ariz. 432, 234 Pac. 35 8

Statutes

Bankruptcy Act Chapter X 7, 10

Bankruptcy Act Chapter XI 7, 10

Bankruptcy Act Sec. 1(8) [11 USC ¶ 1(8)] 8

Bankruptcy Act Sec. 106(3) [11 USC ¶ 506(3)] 8

Treatises

Vol. 6 Collier on Bankruptcy (14th Ed) 3, 7, 8

No. 20841

In the

United States Court of Appeals

For the Ninth Circuit

DESERT DIET DEVELOPMENT CORP., *Appellant*, vs. CHARLES W. HERBERT, WALTER T. MOLL, and MELVIN HELLWITZ, *Appellees.*	

Appellees' Brief

INTRODUCTION

References to the Transcript of Record are indicated as "TR" with appropriate volume indicated.

We do not believe that Appellant has made any effort to comply with Rule 18(d) with respect to specification of errors. From the tenor of the argument advanced by Appellant, it appears that Appellant quarrels with Findings 13 and 14 and Conclusions 3 and 4 of the Special Master adopted by the Court.

Appellant filed objections to Findings 13 and 14 but did not make specific objection to Conclusions 3 and 4. Specification of error No. 1 is a false statement as we shall point out. That portion of Appellant's Specification of Errors set

forth following (2) we do not believe to be any specification of error whatsoever.

SUPPLEMENTAL STATEMENT OF FACTS

Appellees desire to suggest some clarification and amendment to the facts as stated by Appellant.

The mortgage referred to on page 4 of Appellant's Brief, covering virtually all of the corporate property, secured a note to the First Commercial Bank of Chicago. The note and mortgage were assigned by the bank to Harold F. Schwartz. Following the institution of legal proceedings to foreclose the mortgage, the mortgage was purchased by a voluntary group from Mr. Schwartz on or about December 3, 1963. See Exhibit 21 and TR v. 3, pp. 55-57, for details of this transaction. Appellant's Brief is misleading in referring to this group of persons as a syndicate since throughout the record the term "syndicate investors" has been used to describe those who entered into contracts similar to Exhibits 4 and 6. The legal title to the note and mortgage is held by Stewart Title & Trust of Tucson as trustee for a group of co-owners who own in proportion to their contribution. The statement that there are three stockholders in the corporation is not supported by any evidence in the case. This allegation is made in the answer of the debtor, but no evidence whatsoever was offered in this regard and the stock record of the company was not produced. See Finding 9 of the Special Master, TR v. 1, p. 47. Counsel has departed from the record to state that the deed which was filed with the Clerk of the Court (not with the trustee) was a conveyance to all land purchasers. We now apologetically depart from the record to state to the Court categorically that this statement is not true. In the deed described, fifty-three of the lots were described with reference to unrecorded plats so that they have no effect whatsoever as con-

veyances. In addition, there are one hundred forty lot purchases fully paid up that have received nothing at all under the deed. The property of the corporation was abandoned by the management of the corporation and was cared for on a voluntary basis by syndicate investors. Real property taxes were delinquent for a period of about three years. Annual reports to the Arizona Corporation Commission were not made so the corporation was threatened with revocation of its charter. There is substantial evidence of misappropriation or misapplication of funds by management. Practically all of the assets of the corporation were permitted to suffer a foreclosure action which was forestalled by the voluntary action of interested parties. See Finding of Special Master No. 9, TR v. 1, p. 47.

ANSWER TO ARGUMENT I

It is a complete answer to the Specifications of Error that Chapter XI relief is not available to Appellees.

Argument I consists in the main of directing the Court's attention to those cases involving a choice between Chapter X and Chapter XI as appropriate proceedings. Suffice it to say that the Court had no such choice in these proceedings since no Chapter XI petition was before the Court; and in view of the fact that the original petition in Chapter X was filed in July of 1965, it appears unlikely that one will ever be filed. If counsel wish to argue to the Court that Chapter XI proceedings were or are available to the Appellees, counsel is attempting to mislead the Court. Chapter XI is available only upon the voluntary petition of the debtor.

The fact that the debtor has not, and evidently will not, seek relief under Chapter XI should, in and of itself, be enough to establish that Appellees cannot procure adequate relief except under Chapter X. This point is made by Professor Moore, 6 *Collier on Bankruptcy* (14th Edition) 1034.

We quote:

> One situation may prove troublesome. Chapter XI does not authorize creditors to initiate proceedings; only a voluntary proceeding by the debtor is authorized. Suppose then that the debtor corporation has taken no steps under Chapter XI. Does that fact, coupled with the creditors' inability to invoke Chapter XI show that, so far as the petitioners are concerned, adequate relief is not obtainable under Chapter XI? We believe the answer is in the affirmative, but that it will rarely be presented in such a bald fashion.

We will agree with Professor Moore that such a situation should rarely arise, but we have such a situation here. We have here such a case in which the debtor corporation, which is unable to meet its debts as they mature and is threatened with a foreclosure of its entire property, has failed, and evidently proposes to continue to fail, to seek any form of relief under the Bankruptcy Act.

In summary, the entire argument embodied in the Appellant's Brief under Argument I has no application herein. The Court does not have, nor has it ever had, an opportunity to make any selection between Chapter X and Chapter XI as appropriate remedies, and Chapter XI is not available to Appellees.

ANSWER TO ARGUMENT II

Appellant seeks to perpetuate the confusion of some of the earlier casse by referring to Chapter X relief as "drastic" relief, consistently adverting to the fact that Appellant has only three stockholders (a fact totally unsupported in the record, except by allegation in the answer of the debtor corporation), and generally suggesting to the Court that Chapter X relief should be denied, summarizing in what they choose to refer to as the "particular circum-

stances" of the case on page 18 of Appellant's Brief. We will comment on this summary as follows. They state that the Court knows the corporation has three stockholders. If the Court has any such knowledge, it is unshared by counsel, as pointed out in the above fact statement. Appellant blithely ignores the rights of the syndicate owners as equity owners. The statement that the purchasers of real estate have received relief by delivery of a deed to the truste is unsupported in the record, and counsel depart from the record to make the statement, as pointed out in the above fact statement. The statement is not true.

Further, in suggesting that petitioners received complete relief by the deed, counsel for Appellant conveniently ignore that portion of the indebtednesses to petitioners as follows:

$200 for water paid by Hellwitz (Exhibit 18);
$400 for water paid by Moll (Exhibit 19);
$200 for water paid by Moll (Exhibit 20).

It is a gross misstatement to suggest, and counsel in summary appear to suggest, that the deed cured the rights of everybody except syndicate investors. Counsel overlooks the following:

Partial payment on lots, $23,540.50 (TR v. 3, pp. 42, 43);
MITC lots sold, $54,956.95 (TR v. 3, p. 45);
Deposits on houses to be built, including furniture deposits, $77,830.67 (TR v. 3, p. 48);
Loans for the water company never built, $30,500.00 (TR v. 3, p. 51);
Deposits for water service never given, $7,535.67 (TR v. 3, p. 52);
"Short term" loans never repaid, $75,452.00 (TR v. 3, pp. 52, 53).

Next they suggest to the Court that syndicate investors have filed a suit in the state courts of Arizona. We suppose

that they mean to suggest that the declaratory judgment suit filed by some of the syndicate members in a class action gives full and adequate relief to the creditors. There is no specification of error whatsoever in connection with the finding of the Special Master and of the Court that this declaratory judgment suit did not afford adequate relief to the petitioners herein. Under Arizona law relief by way of a state court receivership is ancillary to the principal relief sought. *Ferguson v. Superior Court,* 76 Ariz. 31, 258 P.2d 421. We cannot believe that counsel seriously suggest to the Court that the pending action affords full relief to petitioners. There has been no specification of error sufficient to raise the point.

To get to the meat of the argument, we would suggest three points to the Court:

A. The record here establishes a clear case for Chapter X relief under the guide lines and criteria established by the United States Supreme Court.

B. The members of the syndicate herein are either *de facto* stockholders or equity owners in a class separate from the stockholders, whose rights require determination and adjustment, relief available only in a Chapter X proceeding.

C. Restating a point raised in connection with Argument I, the failure of the corporation to seek relief under Chapter XI in and of itself establishes Chapter X as the only adequate remedy available to petitioners.

We argue these points in order as follows:

A. The confusion in the earlier cases we believe largely attributable to the fact of a failure of understanding that in Chapter X a new remedy was established in the Bankruptcy Court for cases which theretofore could be handled only through the intricate mechanics of the old equity re-

ceivership and 77(b) of the Bankruptcy Act. Somehow some courts seemed to get the idea that it was available only where there was a large, publicly held corporation involved. What some of the early cases seemed to overlook was the fact that a Chapter XI court has the right only to effect a composition of the unsecured claims, and that if it became necessary to alter with the rights of secured creditors or to affect the interests of equity owners that Chapter X exclusively offers this relief. It seems to us that any confusion in this regard should have been put to rest for once and for all in the decision of the Supreme Court in *General Stores Corp. v. Shlensky* (1956), 350 U.S. 462, 76 S.Ct. 516, 100 L.Ed. 550, reaffirmed by a unanimous Supreme Court in *Securities and Exchange Commission v. American Trailer Rentals* (1965), 379 U.S. 594, 85 S.Ct. 513, 13 L.Ed.2d 510. There is an able discussion of the trend of the Supreme Court decisions at 6 *Collier on Bankruptcy* (14th Edition) pp. 841-846. As pointed out therein, the *Shlensky* case seemed to make it very clear that the choice of proceedings rests upon the feasibility of proceeding under either chapter without regard to the size or capital structure of the debtor. As we have pointed out above, the question of choice of proceedings is not before the Court, but certainly this case would seem to put at rest the argument that Chapter X is a "drastic" remedy as suggested by Appellant, or is limited only to corporations with largely held stock issues, which seems to be the innuendo throughout the Appellant's Brief. More important, we believe to be the criteria which have been set forth in the *Shlensky* case, supra (350 U.S. at 466, 76 S.Ct. at 519, 100 L.Ed. at 556), and the criteria which are suggested at 6 *Collier on Bankruptcy* (14th Edition) p. 845.

B. A point blithely ignored in Appellant's Brief is the allegation in the petition referred to in Finding 9 of the

Special Master, (TR v. 1, p. 47), with respect to the status of the syndicate investors. The form of syndicate contract is in the record as Exhibit 4. See also Exhibit 6. The case of *Reilly v. Clyne*, 27 Ariz. 432, 234 Pac. 35, decided by the Arizona Supreme Court, construing the Arizona Constitution, would seem to establish the syndicate investors in a class as *de facto* stockholders. This fact should give the reorganization court no trouble in the light of Section 106(3) of the Bankruptcy Act (11 U.S.C., Sec. 506(3)[1], which carries into Chapter X the broad definition of corporation embodied in Section 1(8) of the Bankruptcy Act (11 U.S.C., Sec. 1(8);[2] but regardless of whether the syndicate investors are *de facto* stockholders, on the face of the contract they are equity owners whose interests require determination and adjustment. As far as many and widespread investors are concerned, the original petition embodies the allegation, specifically admitted in the answer, that syndicate agreements were entered into with approximately 100 people throughout the United States with a total investment of about $300,000. See Finding 9 of the Special Master (TR v. 1, p. 47), to which there is no specification of error, and summary of syndicate investors embodied in Exhibit 8. Of particular interest are the criteria suggested at 6 *Collier on Bankruptcy* (14th Edition), p. 845, which the author suggests as factors of "extreme importance" in passing upon the desirability of Chapter X relief. Going through these in order, we suggest their applicability to this case as follows:

Substantial Evidence of Misappropriation:

The Court's attention is invited to Finding 10(d) of the Findings of the Special Master (TR v. 1, p. 48), to which

1. See Appendix B.
2. See Appendix B.

there is no specification of error, pointing out the fact that one Howard Inches, who appears to be an officer in the corporation, was paid a sum in excess of $195,000 from the period 1959 through 1963 on a personal account, the payments appearing to have been made for personal expenses, such as alimony, schooling for the children, unvouchered credit card expenses and the like.

Going to the next criterion suggested:

Evidence of a Need for New Management:

The Court's attention is invited to Finding 10 of the Special Master (TR 1, pp. 47-49), to which there is no specification of error, setting forth facts indicating either poor management or a total lack of management.

Proceeding to the next criterion suggested:

The Evidence of a Need for a Thorough Examination by a Distinterested Trustee:

We suggest to the Court a perusal of Finding 5 (TR v. 1, p. 46), Finding 9 (TR v. 1, p. 47), and Finding 10 (TR v. 1, pp. 47-49), to which there is no specification of error, pointing out the entire absence of any intelligent management whatsoever. We respectfully submit to the Court that the case at hand meets the criteria suggested by the Supreme Court, and we believe it to be most obvious that no other review is available. Even if Chapter XI relief were available to the Appellees, which it is not, we believe it too plain for argument that a composition of unsecured debt is no answer to these problems.

In the *Shlensky* (supra) case the Supreme Court pointed out (350 U.S. at 466, 76 S.Ct. at 519, 100 L.Ed. at 556) the following as "typical instances" where Chapter X provides the more adequate remedy:

> The character of the debtor is not the controlling consideration in a choice between c. X and c. XI. Nor is the nature of the capital structure. * * * The essential

> difference is not between the small company and th
> large company but between the needs to be served.
>
> Readjustment of all or a part of the debts of an in
> solvent company without sacrifice by the stockholder
> may violate the fundamental principle of a fair an
> equitable plan * * * as the United States Realty Co
> case emphasizes.
>
> Readjustment of the debt structure of a company with
> out more may be inadequate unless there is also an
> accounting by the management for misdeeds which
> caused the debacle.
>
> Readjustment of the debts may be a minor problem
> compared with the need for new management. Without
> a new management today's readjustment may be a
> temporary moratorium before a major collapse.

The facts of this case bring it squarely within each one of these "typical instances."

C. We would like to reiterate the answer set forth to the Appellant's Argument I, calling attention of the Cour to the fact that only Chapter X relief is available to these Appellees, who must proceed on an involuntary basis since the company refuses to do anything about its own problems

We summarize the argument as follows:

1. There is no question before the Court as to any choice between Chapter X and Chapter XI. No Chapter X petition has been filed, and Chapter XI relief is not avail able to these petitioners.

2. A simple composition of the unsecured debt would be grossly inadequate relief as far as other creditors, stock holders and investors are concerned.

3. The facts of this case bring it squarely within the criteria suggested by the text writers and by the Supreme Court of the United States as to the propriety and desir ability of Chapter X relief.

CONCLUSION

We suggest to the Court that this appeal is devoid of merit and that no right or interest of Appellant is being served by this appeal. We share the incredulity of the Special Master hearing the petition evidenced by his conversation with counsel for Appellant at the conclusion of the hearing:

> THE REFEREE: I'm curious, Mr. Van Slyke, when you answer for the corporation asking that the petition be dismissed, that the viedence (sic) here shows that it's been abandoned, no taxes have been paid, what does this corporation intend to do if it is dismissed?
>
> MR. VAN SLYKE: I'm not in a position to answer that, if the Court please.
>
> THE REFEREE: Well, it seems to me that somebody should be here in support of the petition to dismiss and state the reasons why.
>
> MR. VAN SLYKE: The Court might be right, but I'm not in a position to answer that or produce anyone.
>
> THE REFEREE: It would seem to me that this debtor corporation ought to be here trying to take advantage of some reorganization proceeding rather than let all its participating parties, their money go down the drain.
>
> I just don't understand the theory back of the contest by the debotr (sic). And you have no answer?
>
> MR. VAN SLYKE: I have no answer. (TR v. 3, p. 138, line 20 to p. 139, line 16)

We find no single case or authority cited in Appellant's Brief supporting its position as applied to this case. We are constrained to believe that the appeal has been interposed for delay in the interest of one or more individual stockholders who would rather see the company and its

> difference is not between the small company and the large company but between the needs to be served.
>
> Readjustment of all or a part of the debts of an insolvent company without sacrifice by the stockholders may violate the fundamental principle of a fair and equitable plan * * * as the United States Realty Co. case emphasizes.
>
> Readjustment of the debt structure of a company without more may be inadequate unless there is also an accounting by the management for misdeeds which caused the debacle.
>
> Readjustment of the debts may be a minor problem compared with the need for new management. Without a new management today's readjustment may be a temporary moratorium before a major collapse.

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1. There is no question before the Court as to any choice between Chapter X and Chapter XI. No Chapter XI petition has been filed, and Chapter XI relief is not available to these petitioners.

2. A simple composition of the unsecured debt would be grossly inadequate relief as far as other creditors, stockholders and investors are concerned.

3. The facts of this case bring it squarely within the criteria suggested by the text writers and by the Supreme Court of the United States as to the propriety and desirability of Chapter X relief.

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>
> MR. VAN SLYKE: I have no answer. (TR v. 3, p. 138, line 20 to p. 139, line 16)

We find no single case or authority cited in Appellant's Brief supporting its position as applied to this case. We are constrained to believe that the appeal has been interposed for delay in the interest of one or more individual stockholders who would rather see the company and its

creditors "go down the drain" than lose control. Certainly the Appellant-debtor is receiving no benefit by this appeal.

Respectfully submitted,

Charles D. McCarty
1110 Phoenix Title Building
Tucson, Arizona
Attorney for Appellees

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Charles D. McCarty

(Appendices Follow)

Appendix A

INDEX TO EXHIBITS

Appellant has not complied with Rule 18 2 (f). Accordingly, for the convenience of the Court, the following is an index of the identification, offer and admission of the exhibits referred to in this brief. All page references are to TR v. 3.

Exhibit	Identified	Offered	Received
4	p. 21	p. 22	p. 22
6	p. 23	p. 23	p. 24
8	p. 28, 29	p. 77	p. 77
18	p. 101	p. 101	p. 101
19	p. 108	p. 108	p. 109
20	p. 110	p. 111	p. 112
21	p. 115	p. 115	p. 116

Appendix B

STATUTES CITED

Section 1(8) of the Bankruptcy Act [11 U.S.C. 1(8)].

1. *Meaning of words and phrases*

The words and phrases used in this title and in proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows:

* * * (8) "Corporation" shall include all bodies having any of the powers and privileges of private corporations not possessed by individuals or partnerships and shall include partnership associations organized under laws making the capital subscribed alone responsible for the debts of the association, joint-stock companies, unincorporated companies and associations, and any business conducted by a trustee or trustees wherein beneficial interest or ownership is evidenced by certificate or other written instrument; * * *

Section 106(3) of the Bankruptcy Act [11 U.S.C. 506(3)]:

506. *In general*

For the purposes of this chapter, unless inconsistent with the context—

* * * (3) "corporation" shall mean a corporation, as defined in this title, which could be adjudged a bankrupt under this title, and any railroad corporation excepting a railroad corporation authorized to file a petition under section 205 of this title; * * *

No. 20,841

IN THE

United States Court of Appeals

For the Ninth Circuit

In the Matter of
DESERT DIET DEVELOPMENT CORPORATION,
Debtor.

DESERT DIET DEVELOPMENT CORPORATION,
Appellant,

vs.

CHARLES W. HERBERT, WALTER T. MOLL, and MELVIN HELLWITZ,
Appellees.

On Appeal from the United States District Court for the District of Arizona

REPLY BRIEF FOR APPELLANT

CLAGUE A. VAN SLYKE,
182 North Court Street,
Tucson, Arizona 85701,
Attorney for Appellant.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO, CALIFORNIA

Subject Index

Page

Argument I—Adequate relief 2

Argument II—Drastic relief 2

Comments on appellees' "Conclusion" 3

Conclusion 4

Table of Authorities Cited

Cases

Page

Reilly v. Clyne, 27 Ariz. 432, 234 Pac. 35 3

Securities and Exchange Commission v. American Trailer Rentals Co., 85 S. Ct. 513, 379 U.S. 594 (1965), 13 L.Ed. 2d 510 2

Statutes

Bankruptcy Act, Chapter X 4

No. 20,841

IN THE

United States Court of Appeals

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DESERT DIET DEVELOPMENT CORPORATION,
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vs.
CHARLES W. HERBERT, WALTER T. MOLL, and MELVIN HELLWITZ,
Appellees.

On Appeal from the United States District Court for the District of Arizona

REPLY BRIEF FOR APPELLANT

The Appellant sets forth below limited comments on the arguments previously made by both the Appellant and Appellees.

ARGUMENT I—ADEQUATE RELIEF

The fact that the petitioners could not file an "involuntary Chapter XI" seems to be the Appellees' ground for argument that the usual tests of "adequate relief" do not apply. No citations were offered in support of the proposition.

The Court is referred again to *Securities and Exchange Commission v. American Trailer Rentals Co.*, 85 S. Ct. 513, 379 U.S. 594 (1965), 13 Law Ed.2d 510 at 516. The Court of Appeals commented,

> "Since the granting of the motion rests in the discretion of the [district] court, while we think it is a borderline case, it does not appear that *the Securities and Exchange Commission* [as the petitioners in the case at Bar] *has shown adequate relief is not obtainable in Chapter XI proceedings.* . . ."

At page 518:

> "Congress has made it quite clear that Chapters X and XI are not alternate routes . . . a Chapter X petition may not be filed unless 'adequate relief' is not obtainable under Chapter XI."

It is the Appellant's contention that the petitioners failed completely in this essential item of proof.

ARGUMENT II—DRASTIC RELIEF

It is the position of the Debtor that the relief requested by the petitioners is *drastic*. To ask that a corporation be completely re-organized to secure

issuance of deeds to land purchasers and to determine if a "profit" is available to distribute to syndicate holders is, in the opinion of counsel, a drastic step. To place this power in the hands of the Court without strict controls seems to be beyond the scope of the authority set forth in those cases cited in the Appellant's Opening Brief.

The Appellees refer to *Reilly v. Clyne,* 27 Ariz. 432, 234 Pac. 35, which would "seem to establish the syndicate investors as *de facto* stockholders". This issue has not been adjudicated and is not before the Court at the present time. The fact cannot be disregarded that the syndicate holders are in fact one and the same with the Stewart Title and Trust Company Trust, which owns the mortgage on the realty in question.

COMMENTS ON APPELLEES' "CONCLUSION"

The Appellees in their "conclusion" on page 11 of their brief refer to the fact that the Debtor corporation, through its counsel, produced no witnesses at the hearings and did not wish to take "advantage of some re-organization proceeding rather than let all its participating parties, their money go down the drain".

The position of the corporation is far from the "conclusion" drawn by the Appellees that the corporation intends to "go down the drain." The corporation is before the Court, protecting its legal rights, and insisting that drastic remedies are being applied to it for which there is no necessity.

The Court's attention is called to Findings of Fact Nos. 7, 8, and 9, which show that the corporation has substantial equity. The corporation feels that the procedure it is following is in the best interests of all parties. The efforts of the Appellees to second guess the corporation appears to be obvious.

CONCLUSION

It is respectfully submitted that under Chapter X of the Bankruptcy Act and the cases as submitted, that the Order of the District Judge and of the Referee be set aside and the involuntary petition filed against the corporation be dismissed.

Dated, Tucson, Arizona,
December 22, 1966.

Clague A. Van Slyke,
Attorney for Appellant.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Clague A. Van Slyke,
Attorney for Appellant.

No. 20843

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Title Insurance and Trust Company, Executor of the Estate of Ludwig G. B. Erb, Deceased,

Appellant,

vs.

The United States of America.

On Appeal From United States District Court for the Southern District of California, Central Division.

APPELLANT'S OPENING BRIEF.

Bodkin, Breslin & Luddy,
Henry S. Bodkin, Jr.,
Harry A. Olivar,
4201 Wilshire Boulevard,
Suite 400,
Los Angeles, Calif. 90005,
Attorneys for Appellant.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

TOPICAL INDEX

Page

Statement of procedure 1

Statement of jurisdiction 2

Statement of the case 3

1. The facts 3

2. The pleadings, other papers and stipulations upon which the Court granted the Summary Judgment 10

Argument 12

The United States District Court erred in granting defendant-appellee's Motion for Summary Judgment and in ordering that the executor of decedent's estate was not entitled to recover any federal estate tax upon its claim of deduction for charitable bequests under Section 2055 of the Internal Revenue Code of 1954 (26 United States Code Section 2055). 12

I.

Legislative and judicial background 14

A. The statute and regulations 14

B. Supreme Court decisions 15

C. Ninth Circuit decisions 20

II.

State law rules of construction 25

A. Document must be construed as a whole 26

B. Trustor's intent is apparent from a consideration of the changes effected by the 1955 Amendment 31

Page

C. Rules for construction of writings make it clear that trustee's power of invasion was limited to instances where invasion is "necessary" to meet life beneficiary's wants or needs 32

III.

Emma's accustomed standard of living constitutes an ascertainable standard 37

Conclusion 41

TABLE OF AUTHORITIES CITED

Cases — Page

Bader v. Coale, 48 Cal. App. 2d 276 36

Blodget v. Delaney, 1 Cir., 201 F. 2d 589 ....38, 40

Coberly v. Superior Court, 231 Cal. App. 2d 685 30

Commissioner v. Bank of America, 133 F. 2d 753 ....20, 24

Commissioner v. Robertson's Estate, 141 F. 2d 855 .. 39

Commissioner v. Wells Fargo Bank, 145 F. 2d 130 .. 22

Di Maria v. Bank of California, 237 Cal. App. 2d 254 30

Ferrall, Estate of, 41 Cal. 2d 166 29

Henslee v. Union Planters National Bank, 335 U.S. 595 ....18, 19, 20

Ithaca Trust Co. v. United States, 279 U.S. 151 ....15, 19, 20, 24, 38, 39

Kohn v. Kohn, 95 Cal. App. 2d 708 35

Lincoln Rochester Trust Co. v. Commissioner, 181 F. 2d 424 39

Lincoln Rochester Trust Co. v. McGowan, 217 F. 2d 287 40

Mary Cotton Wood, Estate of, 39 T.C. 919 40

McFadden v. Lick Pier Co., 101 Cal. App. 12 36

Mercantile-Safe Deposit and Trust Co. v. United States, 252 Fed. Supp. 191 38

Merchants National Bank v. Commissioner, 320 U.S. 256 ....16, 18, 19, 20, 24, 29

National Bank of Commerce of San Antonio v. Scofield, 169 F. 2d 145 42

Newby v. Anderson, 36 Cal. 2d 462 34

Page

Queen Insurance Co. of America v. United States National Bank of San Diego, ... F. 2d .... (9th Cir., July 18, 1966) 31

Ringrose v. Gleadall, 17 Cal. App. 2d 664 32

Transportation Guarantee Company v. Jellins, 29 Cal. 2d 242 34

United States v. Powell, 307 F. 2d 821 40

Miscellaneous

Internal Revenue Bulletin 54-285 (IRB 1954-29) 37

Regulations

Treasury Regulations on Estate Tax, Sec. 20.2055-2 14

Rules

Federal Rules of Civil Procedure, Rule 3(d)(2) 10

Federal Rules of Civil Procedure, Rule 56 10

Statutes

California Civil Code, Sec. 1637 33

California Civil Code, Sec. 1638 25

California Civil Code, Sec. 1639 33

California Civil Code, Sec. 1641 33

California Civil Code, Sec. 1643 33

California Civil Code, Sec. 1647 33

California Civil Code, Sec. 1650 33

California Civil Code, Sec. 1652 33

Internal Revenue Code of 1939, Sec. 812(d) 14

Internal Revenue Code of 1954, Sec. 2055 .... 12, 14, 41, 42

Page

United States Code, Title 26, Sec. 2055 ....12, 14, 42

United States Code, Title 26, Sec. 7422 2

United States Code, Title 28, Sec. 1291 2

United States Code, Title 28, Sec. 1346(a)(1) 2

United States Code, Title 28, Sec. 1402(a)(2) 2

Textbooks

12 California Jurisprudence 2d, p. 332 ....34, 35

12 California Jurisprudence 2d, p. 333 34

12 California Jurisprudence 2d, p. 359 36

48 California Jurisprudence 2d, Sec. 77, pp. 720-721 26

Restatement of the Law of Trusts, 2d, Sec. 183 30

Restatement of the Law of Trusts, 2d, Sec. 232 30

No. 20843

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Title Insurance and Trust Company, Executor of the Estate of Ludwig G. B. Erb, Deceased,

Appellant,

vs.

The United States of America.

APPELLANT'S OPENING BRIEF.

Statement of Procedure.

The plaintiff-appellant sued in the District Court for the Southern District of California, Central Division, for the recovery of Estate Tax and interest assessed by defendant-appellee and paid under protest. Plaintiff-appellant contended that it was entitled to a deduction in the amount of certain charitable bequests to tax-exempt charitable institutions. In said action plaintiff-appellant also sought a further recovery based on the deductibility of its reasonable attorneys' fees incurred in bringing the action and presenting the preceding Claim for Refund and related matters.

On January 12, 1966, the District Court (per Honorable Harry C. Westover) awarded a Summary Judgment upon defendant-appellee's motion. Said Summary Judgment determined that appellee is not entitled to a deduction on account of the charitable bequests but pro-

vided for the retention of jurisdiction by the Court to determine the amount of any deduction for "attorneys' fees and expenses incurred in connection with contesting the deficiency assessed and prosecuting the Claim for Refund in this action, including any appeal from this Judgment, upon proof thereof to the Court" [R. 204-205].

Statement of Jurisdiction.

The basis of jurisdiction in this case is the fact that it arises under the laws of the United States. Jurisdiction and venue of the cause in the District Court were conferred by Title 28 United States Code, Sections 1346(a)(1) and 1402(a)(2) and Title 26 United States Code, Section 7422. This Court has jurisdiction to consider this appeal pursuant to Title 28 United States Code, Section 1291 because the Summary Judgment appealed from is a final decision of a United States District Court.

The pleadings and facts which disclose the basis upon which it is contended that the District Court had, and this Court has, jurisdiction are as follows: the Complaint alleges that on or about October 20, 1959, plaintiff-appellant, as Executor of the Estate of Ludwig G. B. Erb, deceased, filed a Federal Estate Tax Return (Treasury Department Form 706) with the District Director of Internal Revenue at Los Angeles, California; that the amount of estate tax reflected on the return as due was paid when said return was filed; that a deficiency of $92,669.58 was assessed against plaintiff-appellant on or about October 5, 1962 by the Internal Revenue Service; that on December 28, 1962 and February 18, 1963 said deficiency plus interest thereon was paid by plaintiff-appellant under protest;

that on or about November 12, 1963 plaintiff-appellant filed a Claim for Refund with the District Director of Internal Revenue; that on or about February 6, 1964 the Commissioner of Internal Revenue rejected said Claim for Refund in its entirety; that said District Director of Internal Revenue wrongfully has collected from plaintiff-appellant the sum of $81,742.54 plus interest thereon.

On September 2, 1965, defendant-appellee filed in the United States District Court for the Southern District of California, Central Division, its Notice of Motion and Motion for Summary Judgment. On November 8, 1965 said District Court (per Honorable Harry C. Westover) filed a Memorandum of Decision ordering judgment for defendant-appellee. On January 12, 1966 and January 13, 1966, respectively, the Summary Judgment herein appealed from was lodged, filed and entered. On February 11, 1966 appellant herein timely filed its Notice of Appeal.

Statement of the Case.

1. The Facts.

Ludwig G. B. Erb (hereinafter referred to as "Ludwig") was born on November 3, 1875. He died, a resident of Los Angeles County, California, on July 31, 1958 at the age of eighty-two years [R. 63, 196]. Ludwig had married Emma Erb (hereinafter "Emma") in 1898. They had no children. Emma followed Ludwig in death on August 31, 1962; at her death she was eighty-seven years old [R. 196-197].

Ludwig had originally been engaged in the motion picture business until his retirement in about 1927. Thereafter he managed his investments but was not otherwise actively engaged in business [R. 152].

During the latter twenty-five years of their marriage, the Erbs lived very conservative lives. Although their combined estates had a value in excess of $1,-800,000.00, they never owned a high-priced automobile and lived in a partially-furnished apartment renting for $375.00 per month. Emma continued to reside in the same apartment until her death. They seldom entertained or had visitors. They took no trips abroad during their marriage, although after Ludwig's death Emma visited Honolulu in 1959, 1960 and 1961 [R. 144-145].

Emma owned no jewelry except costume jewelry worth $20.00. She owned one fur jacket valued at $200.00. When Ludwig died his funeral, arranged by Emma, cost but $454.15 [R. 145, 199].

Under date of April 20, 1942 Ludwig, by a Declaration of Trust, created an *inter vivos* trust, No. P-10551 which named appellant Title Insurance and Trust Company (hereinafter "T.I.") as trustee [R. 64, 197].

Generally said trust provided that the income from the corpus was to be distributed to Ludwig during his lifetime, and upon his death, in the event that Emma survived him, to Emma during her lifetime. Said trust further provided that, upon the death of both Ludwig and Emma, after certain distributions of corpus, the income from the remaining corpus should be distributed to certain named individuals and, upon the death of said persons, the trust should terminate and the corpus then existing should be divided among the following named six charitable institutions: Goodwill Industries of Southern California; Hathaway Home for Children; McKinley Home for Boys; Braille Institute of America, Inc.; Salvation Army of California; and Pacific Home [R. 64, 197].

On January 8, 1947 said Declaration of Trust was amended in certain particulars not pertinent to the issues in this action [R. 65, 198].

The Declaration of Trust, in its original form contained Section Six which provided:

> "If at any time or times during the life of this Trust, the Trustor—and after his death, the said Emma Erb if she shall survive him—shall be in want of additional moneys for reasonable support, care and comfort, or for expenses of accident, illness or other misfortune, in each such case of a want, it shall be the duty of the Trustee—upon receipt by it of evidence satisfactory and conclusive of such want—to pay to, or to use, or to apply, or to expend for the said Trustor or his said wife, as the case may be, such portion or portions of the corpus of this trust estate, up to and including the whole thereof, as the Trustee may deem necessary to meet such want." [R. 64-65, 197-198].

In November, 1954, Ludwig consulted a long-time friend, Attorney Henry G. Bodkin, about the preparation of a new Will and a review of the once-amended Declaration of Trust [R. 143]. As appears in Bodkin's affidavit:

> "At that time, Mr. Erb stated to me that, although Mrs. Erb had a substantial estate of her own, he was particularly interested in being assured that she would, in the event of his death, be fully protected and assured of having sufficient funds to live out her life in the manner to which she had been accustomed.
>
> "Upon examining the Declaration of Trust and noting the language of SECTION SIX thereof

(the power of invasion clause) I recalled and recounted to Mr. Erb a prior experience of mine involving a trust in which the trustee was Title Insurance and Trust Company. As I told Mr. Erb, in that instance the Title Company had refused to consider legal expenses of a trust beneficiary, incurred in successfully obtaining her restoration to competency and termination of guardianship as necessities which it could pay with trust funds. I told Mr. Erb that Title Insurance like most corporate trustees, was a very conservative trustee and that in order to be certain that Mrs. Erb would be assured of sufficient money to live in her accustomed manner, perhaps some revision of ARTICLE SIX of the Trust should be considered. Mr. Erb stated that he did not want Mrs. Erb to be in a position to use money from the Trust for frivolous purposes but did want to be certain that the trustee would have ample power to see that her reasonable wants and needs were provided.

"I also expressed my concern to Mr. Erb that, in view of the language of SECTION SIX, as it then existed, the trustee's right or power to invade the corpus was dependent upon the trustee's having received 'evidence satisfactory and conclusive of (Emma's) such want.' Upon my advice, the elimination of this phrase was authorized by Mr. Erb. . . .

"While discussing Mr. Erb's Will, I recommended that, in order to obtain the benefit of the marital deduction, his Trust be amended and his Will drawn so that Mrs. Erb would receive half of the estate outright or at least a power of appointment over one-half of the Trust corpus.

I further recommended to him that as to the remaining half of the Trust corpus, Mrs. Erb have the income for life, but no power of appointment. Mr. Erb declined to accept my advice in these respects, and thereby substantially reduce the taxes payable upon his death. He stated that he simply wanted to be sure that his wife was adequately provided for after his death and that the charities likewise received their allotted shares of the trust estate. He therefore did not authorize the revision of the Trust and drafting of a Will as would give Mrs. Erb a power of appointment over any part of his estate or Trust." [R. 143-145].

Bodkin thereafter prepared a further amendment to said Declaration of Trust which was executed on January 4, 1955, and which modified the language of Section Six in certain respects to read as follows:

"If at any time or times during the life of this trust, the Trustor—and after his death, the said EMMA ERB, if she shall survive him—shall be in want of additional moneys for reasonable support, care and comfort, or for expenses of accident, illness or other misfortune, or for any purpose whatsoever, whether included in the foregoing classification or not; in such case of want or need it shall be the duty of the Trustee, in its sole uncontrolled discretion, to pay to or to use or to apply or to expend for the said Trustor or EMMA ERB, his said wife, as the case may be, such portion or portions of the corpus of this trust estate, up to and including the whole thereof, as the Trustee may deem necessary to meet such want." [R. 65-66, 198].

After Ludwig discussed the amendment with H. L. Sheldon, T. I.'s Trust Officer in charge of Trust P-10551, Ludwig and officers of T. I. executed the said amendment on January 4, 1955. Sheldon averred in his affidavit as follows:

> "I discussed with Mr. Erb and his attorney, Henry G. Bodkin, the reasons for the changes in the language of said SECTION SIX of said Trust instrument at or about the time of the making of said amendment.
>
> "Based upon my understanding and interpretation of said SECTION SIX, as amended, and of Mr. Erb's intentions which prompted the amendment, I would not have invaded the corpus of said trust for the benefit of Mrs. Erb unless said invasion was reasonably necessary to permit Mrs. Erb to live in the manner to which she had been accustomed prior to Mr. Erb's death and then, only if Mrs. Erb did not have sufficient funds available from other sources to pay the costs of supporting and maintaining her in such manner.
>
> "As said SECTION SIX was understood by me, as the Officer in charge of said Trust, invasion of corpus was not intended to be authorized for any purpose other than such reasonable expenses as might be incurred in permitting Mrs. Erb to be supported, maintained, cared for and enjoy such comforts as she had during the lifetime of Mr. Erb." [R. 150-151].

A few days before the Trust was amended, on December 28, 1954, Ludwig executed his last Will. This testament, admitted to probate, named T. I. as Executor and

gave the residue of Ludwig's estate to T. I. to be held as a part of said Trust No. P-10551 [R. 66, 199].

At the time of his death on July 31, 1958, Ludwig's gross estate totalled $995,851.17 [R. 199]. The decree of final distribution transferred the residue of the estate, valued at $705,201.77 to T. I. as trustee of Trust No. P-10551 on January 29, 1960 [R. 199].

On January 4, 1955, the date of the above amendment to Section Six, Emma's life expectancy was 9.6 years. On July 31, 1958, the date of Ludwig's death, Emma's life expectancy based on mortality tables, was 8.3 years [R. 145, 199].

Emma died August 31, 1962, owning an estate worth $920,350.76, no part of which had been included in Ludwig's estate [R. 98]. During the balance of Emma's life after Ludwig's death she enjoyed a substantial income from her own estate. Her separate income plus that which she received by way of income from Trust No. P-10551 is reflected below [R. 148, 199].

	Emma's Private Income	Income from Trust No. P-10551	Emma's Total Income
1959	26,190.87	1,755.07	27,945.94
1960	27,927.57	32,338.95	60,266.52
1961	31,944.56	22,001.89	53,946.45
1962*	35,080.95	1,471.73	37,552.66

During said interval between Ludwig's death and Emma's death, Emma's bank accounts increased by

*Eight months only — January 1 to August 31, 1962.

$36,464.91, she acquired federal, state and local bonds totalling $55,000 and she invested $25,042.73 in trust deed notes. It is thus apparent, that out of a gross income of $205,666.36 (less state and federal income taxes of $68,120.80) she saved or invested $116,507.64 and expended the balance of $81,037.58 for other purposes, including living expenses [R. 199].

Based upon the Trustee's understanding and interpretation of said Section Six, as amended, and of Ludwig's intentions which prompted the amendment, the trustee would not have invaded the corpus of said trust for the benefit of Emma unless said invasion was reasonably necessary to permit Emma to live in the manner to which she had been accustomed to prior to Ludwig's death and then, only if Emma did not have sufficient funds available from other sources to pay the costs of supporting and maintaining her in such manner [R. 151].

At no time after Ludwig's death was the corpus of said Trust No. P-10551 ever invaded [R. 147, 200]. The entire principal of the trust will go to the above named charities as remaindermen.

2. The Pleadings, Other Papers and Stipulations Upon Which the Court Granted the Summary Judgment.

The Motion for Summary Judgment was filed pursuant to Rule 56 of the Federal Rules of Civil Procedure and local Rule 3(d) (2) of the District Court. The appellee's moving papers consisted of the Notice of Motion [R. 77], the pleadings, *i.e.*, the Complaint [R. 2] and Answer [R. 45] and the Pre-trial Stipulation of

Facts Agreed Upon [R. 63]. In reply, appellant submitted the affidavits of the following persons: Henry G. Bodkin, attorney for the decedent who drafted the language here in question [R. 143]; W. E. Bell, Trust Officer of appellant [R. 147]; John D. Moore, decedent's public accountant who prepared income tax returns for decedent and his widow [R. 148]; H. L. Sheldon, retired Trust Officer of appellant [R. 150]; Douglas Travers, close friend and one time business associate of decedent [R. 152]; Winifred Larsen, decedent's landlord at his place of residence [R. 154]. Also submitted by appellant was a second affidavit of Henry G. Bodkin [R. 156].

All of the averments of said affidavits were uncontradicted and the appellee expressly conceded the truth of their contents [Rep. Tr. p. 6]. By virtue of the government's failure to controvert said affidavits the Trial Court concluded that no issues of fact remained and that it could properly dispose of the matter on a Motion for Summary Judgment [Rep. Tr. p. 7].

ARGUMENT.

The United States District Court Erred in Granting Defendant-Appellee's Motion for Summary Judgment and in Ordering That the Executor of Decedent's Estate Was Not Entitled to Recover Any Federal Estate Tax Upon Its Claim of Deduction for Charitable Bequests Under Section 2055 of the Internal Revenue Code of 1954 (26 United States Code Section 2055).

The sole issue before this court is whether the District Court erred in granting the government's Motion for Summary Judgment in an action by the Executor of the Estate of Ludwig G. B. Erb, Deceased, to recover Federal estate taxes which said Executor alleges were erroneously and illegally collected. The question before the District Court was whether the value of the remainder interest of certain charities under an *inter vivos* trust created by decedent, which trust was the residuary beneficiary under decedent's Will, was an allowable deduction under Section 2055 of the Internal Revenue Code of 1954 (26 U.S.C. §2055).

The District Court recognized that there were two aspects to this question [Rep. Tr. p. 10]. And although the lower Court used different language to formulate those aspects, they may be more specifically stated as: (1) whether the *inter vivos* trust created by Ludwig provides a sufficiently definite standard limiting the extent of possible invasion for the benefit of Emma so that the value of the charitable remainders were "presently ascertainable" at the time of Ludwig's death; and (2) whether the possibility that the charities would not take was so remote as to be negligible.

The District Court found that the interest claimed by the Executor to have been transferred by Ludwig's Will

to the six charitable institutions specified as remaindermen of the *inter vivos* trust was not ascertainable by the terms of the trust as of Ludwig's death, that the inclusion in Section Six of the Declaration of Trust, as amended, of the language "or for any purpose whatsoever, whether included within the foregoing classification [*i.e.,* the classification of reasonable support, care and comfort, expenses of accident, illness, or other misfortune] or not" made the trustee's power of invasion of corpus so broad that there was no standard of invasion capable of measurement in monetary terms, and that by reason of the failure to provide a readily ascertainable and reliably predictable standard by which the extent of the trustee's power to invade corpus for the benefit of Emma could be determined, it could not be said that the possibility that the charitable transfers would not become effective was so remote as to be negligible. While it does not appear that the determination of whether the possibility that the charities would not take was so remote as to be negligible is to be reached by answering whether there was a standard of invasion "presently ascertainable" at the time of Ludwig's death, it is upon that initial question of whether there was an ascertainable standard of invasion that the District Court erred. The second question of remoteness was not answered by the District Court; and since the government has conceded all the facts set forth by the appellant as being true, there seems little doubt that the second question, if properly considered, would have been answered in the taxpayer's favor.

I.

Legislative and Judicial Background.

A. The Statute and Regulations.

The instant case is governed by Section 2055 of the *Internal Revenue Code* of 1954, 26 U.S.C.A. §2055, which provides in part:

> "(a) IN GENERAL.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers. . . .

* * *

> "(2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes."

Section 2055 of the 1954 Code is essentially similar to Section 812(d) of the 1939 Code under which many of the cases involving the general issue found in the present case have been decided.

Treasury Regulations on Estate Tax (1954 Code), Section 20.2055-2, entitled "Transfers not Exclusively for Charitable Purposes", outlines the requirements of the Treasury for such a deduction. The provisions material to this case read as follows:

> "(a) *Remainders and Similar Interests.* If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest.

"(b) *Transfers subject to a Condition or a Power.* If, as of the date of a decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an estate or interest has passed to or is vested in charity at the time of a decedent's death and the estate or interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable at the time of the decedent's death, the deduction is allowable. If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, the deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of the power. . . ."

B. Supreme Court Decisions.

Three United States Supreme Court decisions have treated factual situations somewhat similar to those in the instant case. The first decision was in *Ithaca Trust Co. v. United States*, 279 U.S. 151 (1929). In the words of the court, at page 154 of *Ithaca:*

"On June 15, 1921, Edwin C. Stewart died, appointing his wife and the Ithaca Trust Company executors and the Ithaca Trust Company trustee

of the trusts created by his will. He gave the residue of his estate to his wife for life with authority to use from the principal any sum, 'that may be necessary to suitably maintain her in as much comfort as she now enjoys.' After the death of the wife there were bequests in trust for admitted charities. The case presents two questions, the first of which is whether the provision for the maintenance of the wife made the gifts to charity so uncertain that the deduction of the amount of those gifts from the gross estate under § 403-(a)(3), supra, in order to ascertain the estate tax, cannot be allowed. Humes v. United States, 276 U.S. 487, 494, 72 L. ed. 667, 670, 48 Sup. Ct. Rep. 347. This we are of opinion must be answered in the negative. The principal that could be used was only so much as might be necessary to continue the comfort then enjoyed. *The standard was fixed in fact and capable of being stated in definite terms of money.* It was not left to the widow's discretion. The income of the estate at the death of the testator and even after debts and specific legacies had been paid was more than sufficient to maintain the widow as required. *There was no uncertainty appreciably greater than the general uncertainty that attends human affairs.*" (Emphasis added.)

In 1943 the Supreme Court decided against the taxpayer on the question of an allowable charitable deduction for the remainder interest in a trust in *Merchants National Bank v. Commissioner,* 320 U.S. 256. In that case, the court wrote, at page 261:

"Decedent's will permitted invasion of the corpus of the trust for 'the comfort, support, mainte-

nance and/or *happiness* of my wife.' It enjoined the trustee to be *liberal* in the matter, and to consider her 'welfare, comfort and happiness *prior* to the claims of residuary beneficiaries,' i.e., the charities.

"Under this will the extent to which the principal might be used was not restricted by a fixed standard based on the widow's prior way of life. Compare Ithaca Trust Co. v. United States, 279. U.S. 151, 73 L. ed. 647, 49 S. Ct. 291. Here, for example, her 'happiness' was among the factors to be considered by the trustee." (Emphasis added.)

At page 262, the Court explained the reason for its decision:

"The salient fact is that the purposes for which the widow could, and might wish to have the funds spent do not lend themselves to reliable prediction. This is not a 'standard fixed in fact and capable of being stated in definite terms of money.' Cf. Ithaca Trust Co. v. U.S., 279 U.S. 151, 73 L. ed. 647, 49 S. Ct. 291, supra. *Introducing the element of the widow's happiness and instructing the trustee to exercise its discretion with liberality to make her wishes prior to the claims of residuary beneficiaries brought into the calculation elements of speculation too large to be overcome,* notwithstanding the widow's previous mode of life was modest and her own resources substantial. We conclude that the commissioner properly disallowed the deduction for estate tax purposes." (Emphasis added).

The most recent Supreme Court decision in this area was in 1949 in *Henslee v. Union Planters National Bank,* 335 U.S. 595. In *Henslee* the will provided:

> "I hereby direct both my executors and my trustees to pay to my mother the sum of Seven Hundred Fifty ($750.00) Dollars a month to be used by her as she sees fit. In the event the income from my estate is not sufficient to pay the said Seven Hundred Fifty ($750.00) Dollars each month, then my executors and trustees are hereby empowered, authorized and directed to encroach on the corpus of the estate to pay said amount and to sell any of the property, real or personal, for this purpose.
>
> "In addition to this amount my said executors and trustees are authorized and empowered to use and expend in their discretion any portion of my estate, either income or principal, for the *pleasure, comfort and welfare* of my mother.
>
> "The *first object to be accomplished* in the administration and management of my estate and this trust is to take care of and provide for my mother in such manner as she may desire and my executors and trustees are fully authorized and likewise directed to manage my estate primarily for this purpose." (Emphasis added).

The court in *Henslee* felt that the facts required a disallowance of the claimed deduction as in *Merchants* because the will did not limit the trustee's right to invade corpus ". . . to conformity with some ready standard—as where, for example, trustees are to provide the prime beneficiary with such sums 'as may be neces-

sary to suitable maintain her in as much comfort as she now enjoys.' " (The pertinent language of *Ithaca.*)

The court in *Henslee* went on to state, at page 598:

> "The stated income here directed to be paid to the mother was 'to be used by her as she sees fit.' Beyond this the trustees were empowered to invade or wholly utilize the corpus of the estate for the mother's 'pleasure, comfort and welfare,' bearing in mind the testator's injunction that 'The first object to be accomplished . . . is to take care of and provide for my mother in such manner as she may desire. . . .' As in the *Merchants Bank Case,* where the trustees had discretion to disburse sums for the 'comfort, support, maintenance and/or happiness' of the prime beneficiary, so here we think it the 'salient fact . . . that the purposes for which the widow could, and might wish to have the funds spent to not lend themselves to reliable prediction.' "

The court will note that the ranks of Justices Douglas and Jackson, who dissented in *Merchants*, were joined in *Henslee* by Justice Frankfurter.

It would appear that the factual distinction among the three cases cited is the interjection in both *Merchants* and *Henslee* of the subjective element of the life beneficiary's "happiness", and the injunction to the trustee in *Merchants* to be liberal in considering such "happiness" and, in *Henslee*, the forthright declaration that the testator's first objective was his mother's support and *happiness* to which the rights of the charitable remaindermen were necessarily subordi-

nate. Commenting upon this latter provision, the *Henslee* court stated at footnote 3, page 599:

> "In view of the *express priority* accorded the mother's wishes, respondents' *fiduciary duty* to the ultimate beneficiaries, private and charitable, was ineffective to guarantee preservation of any predictable fraction of the corpus for disposition after the mother's death. The testator, indeed, made the gifts to charity subordinate not only to his mother's interest, but to that of all the private beneficiaries, stating in his will that charitable interest 'is a residuary bequest . . . and is not to infringe of any of the other legacies hereinbefore provided.' " (Emphasis added.)

The court was obviously impressed by the limitation, in *Ithaca,* of benefits payable out of corpus to those necessary to maintain his mother in her accustomed prior way of life. In *Merchants* the court recognized the advisability of looking to Massachusetts law to see if it was restrictive of the power to invade where an express limitation did not appear. The court expressed doubt that Massachusetts law would be sufficiently restrictive to overcome the absence of a reliable standard it had determined resulted from the language of the will.

C. Ninth Circuit Decisions.

The appellee and the court below dismiss somewhat peremptorily the cases of the Ninth Circuit Court which support appellant's position and are contrary to that urged by appellee. In *Commissioner v. Bank of America,* 133 F. 2d 753, the invasion clause read:

> ". . . by reason of accident, illness, *or other unusual circumstances* so require, such additional sum

or sums as in the judgment of said trustee may be necessary and reasonable under the existing conditions." (Emphasis added.)

The court therein stated, at page 754:

"The taxing statute permits the deduction from gross estate of charitable bequests of the kind made here. The Commissioner argues that where, as here, the bequest is subject to an intervening life estate, the existence of the legal power to invade the corpus, or *the mere possibility of invasion, is sufficient to defeat the deduction.* The Board, however, was of the opinion that on the facts of the case the probability of the trustee's delving into corpus, or even into surplus income, was so inconsiderable as to render the value of the charitable bequests capable of definite ascertainment."

* * *

"The case of Ithaca Trust Company v. United States, 279 U.S. 151, 49 S. Ct. 291, 73 L. Ed. 647, is more nearly akin to the present. There the wife was given the whole of the income for life, with authority on the part of the trustee to use from the principal any sum necessary to suitably maintain the wife 'in as much comfort as she now enjoys.' The court thought the standard was sufficiently fixed and capable of being stated in definite terms of money, and that 'there was no uncertainty appreciably greater than the general uncertainty that attends human affairs.'

"*The case before us exhibits no greater uncertainty.* At the decedent's death the life expectancy of the sister was brief. Her mode of living and the restricted sphere of her activities were known.

> She had independent means, modest in amount, it is true, but substantial for one in her situation. Her living expenses were well within the monthly sum allowed her, even if her own resources be disregarded; and the fixed annuity in turn was so substantially less than the net income of the trust that an excess fund of almost $7,000 accumulated in the four years ending with 1940. Large sums were thus available to meet unusual circumstances such as illness or accident, so that the probability of an invasion of the corpus was remote indeed. *Nothing was left to the sister's discretion; and the discretion of the trustee to meet the designated contingencies was confined to the expenditure of what was reasonably necessary.*" (Emphasis added.)

Compare the presence of the adjective "reasonable" and the adverb "necessary" in Section Six of the Erb trust.

Another Ninth Circuit case is *Commissioner v. Wells Fargo Bank,* 145 F. 2d 130, wherein there was involved a power to invade corpus to assist testator's niece in case of her need "on account of any sickness, accident, want or other emergency." This phrase would seem broader than that in the Erb trust since it provides for invasion for purposes other than "sickness, accident (or) want." Nevertheless in this case the court affirmed a Tax Court decision allowing a deduction for a charitable remainder bequest.

Among the court's comments are the following, at page 131:

> "According to the findings of the Tax Court. decedent's niece was at one time employed as a

saleslady, receiving a maximum of $175 per month. In 1918 she became decedent's companion at a salary of $45 per week. She retained the position until decedent's death. At that time the niece was 54 years of age and possessed independent means valued at approximately $35,000. The appraised value of decedent's residuary estate at the date of her death was $130,000. From the date of its distribution to them on August 18, 1941, until the niece's death on June 22, 1942, the testamentary trustees paid the niece as life beneficiary $300 a month out of the income of the trust. The annual net income of the trust was $4,000, and undistributed income was held by the trustees for the life beneficiary. With the income from her own securities the income of the trust was more than sufficient for her ordinary needs.

"The Tax Court adopted the theory that 'where the possibility of the invasion of the trust principal out of which the charitable bequest is made is so remote as not seriously to affect the ascertainment of the value of the bequest and where, *on the known facts,* the value can be ascertained with reasonable accuracy, the test for the deduction as laid down by the Supreme Court has been met.' It then found 'the likelihood that there would ever be any invasion of the trust corpus * * * so remote as not seriously to detract from the value of the charitable bequest' and held the charitable gift herein within the deductions authorized by 26 U.S.C.A. Int. Rev. Code, §812(d)." (Emphasis added.)

The court followed the Supreme Court decision in *Ithaca* and its own early decision in *Bank of America,* both *supra,* and easily distinguished the then recent Supreme Court decision in *Merchants* as follows, at page 132:

> "In the instant case there is substantial evidence to support the finding of the Tax Court concerning the remoteness of invasion of the trust corpus. The taxpayer has shown with *sufficient certainty* that the entire amount of the principal will be available for charitable purposes in accordance with the directions in the will by a showing of the beneficiary's advanced age, frugality over a long period of time, and independent means. The Merchants National Bank case, supra, is clearly distinguishable on its facts. The opinion therein emphasizes the possibility under the will of draining corpus for the widow's happiness through the trustee's exercise of 'discretion with liberality,' a highly speculative element, which is absent in the instant situation. We therefore find no error." (Emphasis added.)

In the present case it not only can be shown with "sufficient certainty" that the charitable remainder will not be depleted or entirely defeated, but also the power to invade no longer exists. *There has been no invasion of corpus and it is an absolute certainty that the charities will receive their allotted remainder shares.*

II.

State Law Rules of Construction.

In the light of the reasoning of the United States Supreme Court and the Ninth Circuit Court of Appeals in the decisions mentioned above, we may turn to the language of Ludwig Erb's trust and consider its meaning as required under the rules of law in the State of California. Section Six (as amended in 1955), which provides the trustee with a limited power of invasion, reads:

> "If at any time or times during the life of this trust, the Trustor—and after his death, the said EMMA ERB, if she shall survive him—shall be in want of additional moneys for reasonable support, care and comfort, or for expenses of accident, illness or other misfortune, or for any purpose whatsoever, whether included in the foregoing classification or not; in such case of want or need, it shall be the duty of the Trustee, in its sole uncontrolled discretion, to pay to or to use or to apply or to expend for the said Trustor or EMMA ERB, his said wife, as the case may be, such portion or portions of the corpus of this trust estate, up to and including the whole thereof, as the Trustee may deem necessary to meet such want."

California Civil Code, Section 1638, requires that the "language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity." However, it cannot reasonably be said that the language of Section Six quoted above is clear and explicit in that an apparent ambiguity has

arisen regarding the phrase ". . . or for any purpose whatsoever, whether included in the foregoing classification or not." To the trustor, the draftsman, and the trustee—the appellant herein—this phrase clearly and explicitly refers to purposes related to "want or need" as set out in Section Six. The government and the court have interpreted the phrase to give the trustee *carte blanche* to invade the trust corpus for *any purpose*. Even if this were a "reasonable" interpretation of the trust, it becomes an absurdity in that the trustee may not, under the laws of California, so invade the corpus or principal of the trust. Therefore, the local rules of construction become applicable and necessary.

A. Document Must Be Construed as a Whole.

In California, as in most states, it is axiomatic that the instrument creating the trust must be looked to to determine the nature, extent, and object of the trust. It is mandatory that the trust be construed as a whole. As it is stated in 48 Cal. Jur. 2d 720-721, Trusts, §77, entitled "Construction as Whole":

> "In ascertaining the intention of the trustor, the court is not limited to determining what is meant by any particular phrase, but may consider the necessary implication arising from the language of the instrument as a whole. This means that the language in a particular trust declaration is to be interpreted, not as an isolated statement of intention, but in the light of the entire declaration. And a construction of a particular trust provision, though it might be justified if the provision stood alone, should be rejected if it is entirely inconsistent with the apparent purposes of the instru-

ment taken as a whole and would defeat one of the beneficent purpose of the trust. Thus, in analyzing the terms of a testamentary trust instrument, the office of the court is to ascertain the general scheme of the testator by a consideration of the instrument as a whole and to give effect to its scope and purpose as manifested by its language. And the meaning of particular words, phrases, and provisions is subordinated to the scheme, plan, or dominant purpose."

It will be noted from the moving papers filed by the United States in seeking a summary judgment and by the Findings of Fact and Conclusions of Law and Memorandum of Decision of the District Court that both the government and the District Court have singled out the phrase ". . . or for any purpose whatsoever, whether included in the foregoing classification or not"; and each respectively based its entire argument or its decision on the contention that said phrase gives the trustee *carte blanche* to invade the trust corpus for any purpose. Such is clearly not the case.

First of all, in reading the original trust instrument and the amendments thereto, this court will find no indication that the rights of the charitable remaindermen were subordinate to the rights of Emma as life beneficiary. There is no declaration to the trustee that Ludwig's first objective was his wife's support and happiness. Nowhere in the trust is there a direction that the trustee's power of invasion is to be measured by any subjective standard relating to Emma. Nowhere in the trust is there the usual provision that the trustor is to exercise its discretionary power of invasion with liberality.

Far from it. It is quite apparent that the trust had both a private and a charitable purpose. The private purpose was to provide Emma a life income of $20,-000.00 to $30,000.00 (to supplement her own income of thirty thousand dollars or so) and to provide a safeguard in case of misfortune by supplying the trustee with a discretionary power to invade the principal in times of need or want. The charitable purpose was to preserve the corpus of the trust intact for distribution to six specified institutions except in the event that the income was insufficient to maintain Emma in her normal standard of living, which was indeed modest.

The trustor's intent in creating this trust was obviously twofold. The government cannot in good conscience contend that Ludwig subordinated the interests of the six charitable remaindermen to the life tenant when in fact he refused to obtain the tax benefits of the marital deduction because this would require giving Emma a testamentary power of appointment over one-half of the trust corpus. As the result of Ludwig's decision to insure that the charities received the corpus by his not taking advantage of the marital deduction, the net estate tax calculated and paid by the Executor was $144,964.73 (prior to any assessments). The trustor clearly intended to guarantee that the charities would receive the entire principal of the trust corpus unless the income therefrom was unable to provide Emma funds to maintain her standard of living, a possibility so remote as to be negligible.

Further, it is conceded that the trustee would not have invaded the corpus of said trust for the benefit of Emma unless said invasion was reasonably necessary to permit Emma to live in the manner to which she had

been accustomed prior to Ludwig's death and then, only if Emma did not have sufficient funds available from other sources to pay the costs of supporting and maintaining her in such manner [R. 151; Rep. Tr. p. 6]. The trustee's said interpretation is required by California law.

Although, as the court observed in *Merchants National Bank,* various local laws of other states may not restrict a trustee having discretion to invade a corpus by reading into the trust the requirement that the invasion be only to support the life beneficiary in her accustomed manner, there is no doubt that this restriction is imposed upon the trustee by California law.

In *Estate of Ferrall*, 41 Cal. 2d 166, a lifetime beneficiary sued to compel the trustees to invade the corpus for her "care, needs and comforts." An order requiring such an invasion was reversed. The Will provided:

> "That if at any time the income from the corpus of the trust herein created is insufficient to meet the needs of my daughter, Faye F. Hamilton, then and in that event, in the sole discretion of the trustees herein, the trustees may pay to my said daughter, Faye F. Hamilton, such amounts from the principal or corpus of the trust sufficient to meet her needs, care and comforts . . ."

The trustees had refused to comply with a demand that they invade corpus to pay the incompetent life beneficiary's expenses in a sanitarium on the ground that beneficiary's husband had the primary obligation to support her, that the testator intended that the husband not be relieved of the responsibility during the

marriage and that he had the ability to provide for her needs.

The California Supreme Court noted, at page 176, that a trustee must consider a beneficiary's other means in determining whether to invade corpus in the absence of an affirmative expression of contrary intent in the trust instrument. The Court also approved of a comment in the Restatement of Trusts, as follows:

> "The extent of the discretion conferred upon the trustees depends primarily upon the manifestation of the intentions of the settlor . . . The mere fact that the trustee is given discretion does not authorize him to act beyond the bounds of a reasonable judgment."

See also *Coberly v. Superior Court,* 231 Cal. App. 2d 685, 687; *Di Maria v. Bank of California,* 237 Cal. App. 2d 254, 258.

The trustee of Ludwig's trust was further obligated under general trust law to deal impartially as between Emma, a life tenant, and the succeeding beneficiaries, the six charitable remaindermen. It could not invade the corpus to the detriment of the remaindermen, except to provide for Emma's reasonable wants and needs, after considering her other income and means. *Restatement of Trusts,* 2d §183 provides: "When there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them." Section 232 of the same *Restatement* further states: "If a trust is created for beneficiaries in succession, the trustee is under a duty to the successive beneficiaries to act with due regard to their respective interests."

B. Trustor's Intent Is Apparent From a Consideration of the Changes Effected by the 1955 Amendment.

Consideration of the changes effected by the 1955 Amendment to Ludwig's trust is a natural approach to a determination of the meaning of the amendments. As the Ninth Circuit Court recently said in *Queen Insurance Co. of America, v. United States National Bank of San Diego*, ... F. 2d .... (9th Cir., July 18, 1966):

> "Appellants contend that, for the purpose of interpreting the bonds in suit, the court may not look to and compare this clause with the substituted discovery rider for the reason that 'it was never a part of the contract.'"
>
> * * *
>
> "What could be more natural, in trying to discover what the discovery rider does, than to look at the language that it strikes? We do this every day in construing amendments to statutes. Why not also in construing contract documents?"

Said Section Six may be better understood and interpreted if the language before and after the 1955 amendment is considered. The words in the following paragraph, which are lined out are those in the original paragraph which were eliminated in 1955. The italicized words were added in 1955.

> "If at any time or times during the life of this Trust, the Trustor—and after his death, the said EMMA ERB, if she shall survive him—shall be in want of additional moneys for reasonable support, care and comfort, or for expenses of accident, illness or other misfortune, *or for any purpose whatsoever, whether included in the foregoing*

classification or not; in such case of want *or need,* it shall be the duty of the Trustee, *in its sole uncontrolled discretion,* ~~upon receipt by it of evidence satisfactory and conclusive of such want~~ to pay to or to use or to apply or to expend for the said Trustor or *Emma Erb,* his wife, as the case may be, such portion or portions of the corpus of this trust estate, up to and including the whole thereof, as the Trustee may deem necessary to meet such want."

It will be noted that the phrase "or for any other purpose whatsoever, whether included in the foregoing classification or not" relates to and qualifies the previous phrase limiting the power to invade to "support, care and comfort . . . expenses of accident, illness or other misfortune" and that the phrase deemed so important by the government is inextricably tied into the previous phrase is obvious from the way the paragraph is punctuated. The vital phrase which is singled out by the government, is concluded with a semi-colon. The succeeding portion of the paragraph refers first to Emma Erb's "want or need" and later to her "need" and makes it clear that the preceding general phrase is intended to refer only to "wants" or "needs" and not to grant a power to invade for other unlimited purposes.

C. Rules for Construction of Writings Make It Clear That Trustee's Power of Invasion Was Limited to Instances Where Invasion Is "Necessary" to Meet Life Beneficiary's Wants or Needs.

The rules of interpretation of contracts must be applied to trusts. (*Ringrose v. Gleadall,* 17 Cal. App. 2d 664, 667.)

The following California Civil Code sections are applicable to assist in the interpretation of the invasion clause in the Erb Trust:

> §1637: "For the purpose of ascertaining the intention of the parties to a contract, if otherwise doubtful, the rules given in this chapter are to be applied."
>
> §1639. "When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone, if possible; subject, however, to the other provisions of this title."
>
> §1641. "The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other."
>
> §1643. "A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties."
>
> §1647. "A contract may be explained by reference to the circumstances under which it was made, and the matter to which it relates."
>
> §1650. "Particular clauses of a contract are subordinate to its general intent."
>
> §1652. "Repugnancy in a contract must be reconciled, if possible, by such an interpretation as will give some effect to the repugnant clauses, subordinate to the general intent and purpose of the whole contract."

Defendant-appellee has convinced the lower court that the trust instrument was intended to authorize invasion

of the corpus "for any purpose whatsoever" without relation to the life beneficiary's wants, needs, supports, care or comfort. Such an interpretation is unreasonable and would make what is otherwise a clear, unambiguous instrument fraught with uncertainty.

If, as the government urges, the phrase ". . . or for any purpose whatsoever . . ." is interpreted so as to authorize invasion for *any* purpose without being limited to wants, needs, support, etc., the subsequent references to "want" and "need" would be disregarded and the clause would, in effect, be read as follows (with the stricken words disregarded):

> ". . . for reasonable support, care and comfort, or for expenses of accident, illness or other misfortune, or for any purpose whatsoever, whether included in the foregoing classification or not; ~~in such case of want or need~~ it shall be the duty of the trustee, in its sole uncontrolled discretion, to pay to or to use, or to apply for the said trustor or EMMA ERB, his said wife, as the case may be, such portion or portions of this trust estate, up to and including the whole thereof, as the trustee may deem necessary ~~to meet such want.~~"

This process would disregard the rules requiring that every provision be given some effect. (*Transportation Guarantee Company v. Jellins,* 29 Cal. 2d 242, 12 Cal. Jur. 2d 332.) It would ignore the law that particular words or phrases must be subordinated to general intent. (*Newby v. Anderson*, 36 Cal. 2d 462, 12 Cal. Jur. 2d 333). Such an interpretation would overlook the rule

requiring the meaning of a writing to be determined by a reading of the entire instrument and not by isolating one or more clauses. (*Kohn v. Kohn*, 95 Cal. App. 2d 708, 12 Cal. Jur. 2d 332.)

The court will note that, following the phrase relied upon by the appellee, which we urge is simply further descriptive of the prior references to support, etc., the trust instrument in two instances refers to "such want." When the word "such" is first used, it is the second word following the semi-colon concluding the phrase emphasized by the Government. The word "want" first appears at the commencement of the phrase including support, care, comfort, accident, illness, misfortune, "or any purpose whatsoever". Accordingly, the relative adjective "such" must refer to the entire phrase preceding the semi-colon which is then summarized by the phrase "want or need" and at the end of Section Six by the single word "want". The point is that the use of "such", "want" and "need" would be meaningless unless the trustor intended the power of invasion to be limited to supplying Emma's wants or needs and did not intend that the trustee should have *carte blanche* to invade the corpus.

> "Such: This is a relative adjective referring back to and identifying something previously spoken of. By grammatical usage it naturally refers to the last preceding antecedent. In this respect it is equivalent to "said", "aforesaid", "afore-described", and "same", as to all of which the same grammatical rule applies. That is, in the absence of some controlling reason to the contrary they refer

> to the last antecedent. When the word precedes a noun in the singular number, it partakes of the nature of a pronoun as well as that of an adjective; it properly relates to the same noun in the same number as antecedently expressed and qualified, especially to the qualification; it denotes that the noun which it precedes is to be understood as antecedently qualified." (12 Cal. Jur. 2d 359.)

The only possible antecedent of "such" is the entire phrase commencing ". . . shall be in want," and concluding ". . . whether included in the foregoing classification or not".

The general rules of construction compel the conclusion that the addition of the general phrase "or for any purpose whatsoever, whether included in the foregoing classification or not;" when read in the light of the specific items preceding it and the general overall purpose and intent of the language preceding and following it, does not have independent meaning of itself and comes within the rules of "ejusdem generis".

In *Bader v. Coale,* 48 Cal. App. 2d 276, the rule of *ejusdem generis* was stated as a rule of interpretation in which "when general words follow specific terms, the former will be strictly limited in meaning to things of like kind and nature."

The same rule was enunciated in *McFadden v. Lick Pier Co.,* 101 Cal. App. 12, at page 17:

> "It is the rule of construction that where general words follow the enumeration of particular classes of persons or things, the general words will be construed as applicable only to persons or things of the same general nature or class as those enumerated."

III.

Emma's Accustomed Standard of Living Constitutes an Ascertainable Standard.

Internal Revenue Bulletin 54-285 (IRB 1954-29) was rendered in response to a request for advice as to the propriety of a charitable deduction where there was a power to invade for the "comfort, support, hospital or medical expenses" of the testator's surviving wife.

The ruling stated:

> "Where the power of invasion is limited by such words as 'comfort and support' with no express standard or limitation in the will or instrument, such words should be interpreted as meaning the comfort and support according to the standard of living enjoyed by the beneficiary prior to the decedent's death, if such interpretation is consistent with applicable local law, and other terminology in the will or instrument does not require some different interpretation. (The inclusion of the words 'hospital or medical expenses' does not enlarge the power of invasion as hospital and medical care are included within the broad meaning of comfort and support.)"
>
> * * *
>
> "In view of the foregoing it is held that a charitable deduction under section 812(d) of the Internal Revenue Code may be allowed on account of bequests or gifts of remainder interests to charity in cases where the will or instrument authorizes "invasion of corpus for the comfortable maintenance and support of life beneficiaries if (1) there is an ascertainable standard covering com-

fort and support which may be either *express or implied,* and (2) the probability of invasion is remote or the extent of the invasion is calculable in accordance with some ascertainable standard." (Emphasis added).

In *Ithaca Trust Company, supra,* the Supreme Court, at page 154, sustained the right to the deduction saying: "The principal that could be used was only so much as might be necessary to continue the comfort then enjoyed. The standard was fixed in fact and capable of being stated in definite terms of money. It was not left to the widow's discretion."

As stated in *Mercantile-Safe Deposit and Trust Co. v. United States*, 252 Fed. Supp. 191:

> "Following the Ithaca Trust decision, the courts have held that the standard is sufficiently definite where the will permits invasion for the beneficiary's 'comfort and welfare'. Blodget v. Delaney, 1 Cir., 201 F.2d 589 (1953), 'proper care, support and maintenance', Lincoln Rochester Trust Co. v. Commissioner, 2 Cir., 181 F.2d 424 (1950), 'support and maintenance', Berry v. Kuhl, 7 Cir., 174 F.2d 565 (1949), 'to meet any unusual demands, emergencies, requirements or expenses for her personal needs that may arise from time to time', Lincoln Rochester Trust Co. v. McGowan, 217 F. 2d 287, 289 (1957), or for 'the upkeep of the homeplace and all necessary medical and hospital expenses in the case of the illness' of either or both of the testator's sisters, Bowers v. South Carolina National Bank of Greenville, 4 Cir., 228 F. 2d 4 (1955). Granting the trustee discretion

> with respect to the amount to be used for the specified purpose is not fatal. Neither is omission from the will of specific reference to the support or comfort 'then enjoyed'."

Although the trust created by Ludwig Erb did not specifically limit the invasion power to support, etc., in the manner which Emma had previously enjoyed, as was the case in *Ithaca,* it did limit such invasion to moneys necessary for her "reasonable" support, care, comfort, etc .In addition it is conceded that the trustor and trustee intended that the power to invade should be so limited.

In *Commissioner v. Robertson's Estate,* 141 F. 2d 855 (4th Cir., 1944), invasion was authorized "if the best interests of my sister should so require". In the trustee's judgment her best interests required her to be maintained according to her standard of living of the past ten or fifteen years. Judgment for the taxpayer was affirmed and the court noted, at page 857, the Tax Court's finding of fact, to wit:

> "We think it clear, therefore, from the evidence that any uncertainty in the bequests to the charities by reason of the prior authority of the trustee to distribute principal if in his judgment the best interests of the beneficiary should require was negligible. The possibility that the charitable bequests would fail or be diminished was so remote as to be nil."

In *Lincoln Rochester Trust Co. v. Commissioner,* 181 F. 2d 424 (2nd Cir., 1959), invasion was permitted for the beneficiary's "proper care, support and maintenance". The court held that this meant such as

is "suitable or appropriate to the station in life to which she was accustomed" and admitted that interpretation was to be controlled by state (New York) law.

In *Blodgett v. Delaney, supra,* "comfort and welfare" was held to mean, under Massachusetts law, support in accordance with the beneficiary's station in life and accustomed pattern of living. The Treasury Department would do well to heed the following paragraph, appearing at page 594 of the opinion:

> "Many other Courts of Appeals on like reasoning, and also taking into consideration the clear Congressional policy not to benefit the national revenue at the expense of charitable institutions, have in comparable factual situations reached the conclusion of deductibility."

Other cases in which the courts have implied a limitation of the power to invade to instances where it is necessary to render support in a degree to which the beneficiary is accustomed even though no such express limitation is set forth in the will are *Lincoln Rochester Trust Co. v. McGowan,* 217 F. 2d 287; *United States v. Powell,* 307 F. 2d 821; and *Estate of Mary Cotton Wood,* 39 T.C. 919.

The power of invasion in Ludwig's trust, considered in light of the law of the State of California, provides a definite standard limiting the extent of possible invasion for the benefit of the life beneficiary. It has been additionally shown herein that local law enforces such a standard.

Conclusion.

The practical question before the Court is whether the government and the District Court may arbitrarily maintain that no ascertainable standard governs the trustee's power of invasion of the corpus by focusing solely on the phrase ". . . or for any purpose whatsoever, whether included in the foregoing classification or not." This view ignores the mandates of logic, of local law (both in regard to interpretation of instruments and duties of a trustee) and of past decisions of the United States Supreme Court, the Tax Court and the Ninth Circuit Court of Appeals. The ascertainable standard of both the life interest and of the remainder interest is calculable as of the date of Ludwig Erb's death as is required by the Treasury Regulations governing Section 2055 of the Internal Revenue Code of 1954. The life interest is to be measured by the standard of living enjoyed by Emma Erb prior to Ludwig's death. From the facts conceded by the government to be true, the possibility that the charitable transfer will not become effective is so remote as to be negligible. The occurrence of an event which would defeat the interest vested in the charitable remaindermen is not only highly improbable at the time of Ludwig's death, but presently is impossible.

Although after Emma's death on August 31, 1962, there were distributions of corpus, and the trust continues for the benefit of succeeding life beneficiaries, these life beneficiaries are to receive income only and the trustee no longer has the power to invade the cor-

pus for their benefit. Thus the entire trust corpus will be distributed to the following charities, in equal shares:

Goodwill Industries of Southern California,
Hathaway Home for Children,
McKinley Home for Boys,
Braille Institute of America, Inc.,
Salvation Army of California,
Pacific Home.

The court is, of course, aware that an affirmance of the erroneous decision of the trial court will, taking into account interest on the overpayment, deprive each of said charities of a sum in the neighborhood of $17,000.00.

It would seem particularly appropriate, at this point, to quote from the dissenting opinion of Judge Hutcheson of the Fifth Circuit in *National Bank of Commerce of San Antonio v. Scofield,* 169 F. 2d 145, at page 148:

> "Covetousness, rapacity, and greed are as unvirtuous and unlovely in a governmental bureau as they are in the citizen, and courts should be as quick to call them what they are in the one case as in the other."

The decision of the District Court in granting the Government's Motion for Summary Judgment should be reversed, and the Court below directed to enter that:

1. The plaintiff is entitled to recovery of Federal estate tax upon its claim that it was entitled to deduct from decedent's gross estate $297,562.71 as a deduction for charitable bequests under Section 2055 of the Internal Revenue Code of 1954 (26 U.S.C. §2055), and

2. The Court retains jurisdiction of this action for the purpose of determining the amount of any deduction for Federal estate tax purposes to which the plaintiff is entitled for attorney's fees and expenses incurred in connection with contesting the deficiency assessed and prosecuting the claim for refund in this action, including any appeal from this Judgment, upon proof there of to the Court.

Respectfully submitted,

Bodkin, Breslin & Luddy,
Henry G. Bodkin, Jr.,
Harry A. Olivar,
Attorneys for Appellant.

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

Henry G. Bodkin, Jr.

No. 20,843

In the United States Court of Appeals for the Ninth Circuit

TITLE INSURANCE AND TRUST COMPANY, EXECUTOR OF THE ESTATE OF LUDWIG G.B. ERB, DECEASED, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

On Appeal from the Judgment of the United States District Court for the Southern District of California

BRIEF FOR THE APPELLEE

MITCHELL ROGOVIN,
Assistant Attorney General.

LEE A. JACKSON,
HARRY BAUM,
JONATHAN S. COHEN,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

Of Counsel:

MANUEL L. REAL,
United States Attorney.

LOYAL E. KEIR,
Assistant United States Attorney.

INDEX

Page

Opinion below ... 1

Jurisdiction ... 2

Question presented ... 3

Statutes and Regulation involved ... 3

Statement ... 6

Summary of Argument ... 9

Argument:

The District Court correctly held that the trustee's power to invade principal was not limited by an ascertainable standard capable of being stated in definite terms of money, and that the remainder gifts to charity were accordingly ineligible for the charitable deduction allowed by Section 2055 (a) of the Internal Revenue Code of 1954 ... 11

Conclusion ... 31

Certificate ... 32

CITATIONS

Cases:

Berry v. *Kuhl*, 174 F. 2d 565 ... 19
Bowers v. *South Carolina National Bank of Greenville*, 228 F. 2d 4 ... 19
Bowling v. *Newlands*, 112 Cal. 476, 44 Pac. 810 ... 25
Coberly v. *Superior Court*, 231 Cal. App. 2d 685, 42 Cal. Rptr. 64 ... 27
Commissioner v. *Bank of America, Etc.*, 132 F. 2d 753 ... 21, 22
Commissioner v. *Sternberger's Estate*, 348 U.S. 187 ... 13
Commissioner v. *Wells Fargo B. & U. Tr. Co.*, 145 F. 2d 130 ... 21
De Castro's Estate v. *Commissioner*, 155 F. 2d 254 ... 22
Di Maria v. *Bank of California*, 237 Cal. App. 2d 327 ... 29

Cases—Continued | Page

Ferrall, Est. of, 41 Cal. 2d 166, 258 P. 2d 1009 28
Gammons v. *Hassett*, 121 F. 2d 229, certiorari denied, 314 U.S. 673 22
Hartford-Connecticut Trust Co. v. *Eaton*, 36 F. 2d 710 19
Heifetz v. *Bank of America*, 147 Cal. App. 2d 776, 305 P. 2d 979 26
Henslee v. *Union Planters Bank*, 335 U.S. 595 ..9, 10, 12, 13, 16, 20, 21, 22, 29, 30
Ithaca Trust Co. v. *United States*, 279 U.S. 151 .. 12, 18, 19, 20
James v. *Commissioner*, 40 T.C. 494 23
Lincoln Rochester Trust Co. v. *McGowan*, 217 F. 2d 287 19
Lombardi v. *Blois*, 230 Cal. App. 2d 191, 40 Cal. Rptr. 899 26
Lucas v. *Mercantile Trust Co.*, 43 F. 2d 39 19
Marine Trust Co. of Western New York v. *United States*, 247 F. Supp. 278 24
Merchants Bank v. *Commissioner*, 320 U.S. 256 ..9, 10, 12, 13, 16, 20, 21, 22, 29
Merrill Trust Co. v. *United States*, 167 F. Supp. 474 .... 16, 23
Miller, Estate of, 230 Cal. App. 2d 888, 41 Cal. Rptr. 410 27
Moxley v. *Title Ins. & Trust Co.*, 27 Cal. 2d 457, 165 P. 2d 15 26
Newton Trust Co. v. *Commissioner*, 160 F. 2d 175.. 16, 22
Patten, Estate of, 217 Cal. App. 167, 31 Cal. Rptr. 767 26
Ringrose v. *Gleadall*, 17 Cal. App. 664 .... 25, 26
Security First Nat. Bank v. *Wellslager*, 88 Cal. App. 2d 210, 198 P. 2d 700 26
Smith v. *Bank of America, Etc. Assn.*, 14 Cal. App. 2d 78, 57 P. 2d 1363 26
State Street Bank & Trust Co. v. *United States*, 313 F. 2d 29 23
Strite v. *McGinnes*, 215 F. Supp. 513 24
United States v. *Powell*, 307 F. 2d 821 19
Union Nat. Bank v. *Hunter*, 93 Cal. App. 2d 669, 209 P. 2d 621 26

Cases—Continued Page

Warner Est., 183 Cal. App. 2d 846, 7 Cal. Rptr. 319 26
Zentmayer's Est. v. *Commissioner*, 336 F. 2d 488 .. 22

Statutes:

Internal Revenue Code of 1954, Sec. 2055 (26 U.S.C. 1964 ed., Sec. 2055) 3, 11
Civil Code, 10 West's Annotated California Code:
Sec. 2220 25
Sec. 2253 .... 4, 26
Sec. 2254 .... 4, 25, 26

Miscellaneous:

Halbach, Problems of Discretion in Discretionary Trusts, 61 Colum. L. Rev. 1425 (1961) 28
Lowndes and Kramer, Federal Estate and Gift Taxes (1962 ed.), p. 483 16
4 Mertens, Law of Federal Gift and Estate Taxation (1959), pp. 397-398 15
Note, Deduction of a Charitable Remainder, 41 Va. L. Rev. 635, 648 (1955) 16
Paul, Federal Estate and Gift Taxation (1946 Supp.), pp. 436-437 14
Treasury Regulations on Estate Tax, Sec. 20.2055-2 (26 C.F.R., Sec. 20.2055-2) 5, 11

In the United States Court of Appeals for the Ninth Circuit

No. 20,843

TITLE INSURANCE AND TRUST COMPANY, EXECUTOR OF THE ESTATE OF LUDWIG G.B. ERB, DECEASED, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

On Appeal from the Judgment of the United States District Court for the Southern District of California

BRIEF FOR THE APPELLEE

OPINION BELOW

The memorandum of decision of the District Court (I-B R. 166-178)[1] is officially reported at 245 F. Supp. 386. The District Court's findings of fact and conclusions of law in accordance with the momoran-

[1] "I-B R." references are to Section B of Volume I of the reproduced Transcript of Record on review, and "I-A R." references are to Section A of Volume I of the Transcript of Record.

dum of decision (I-B R. 195-203) are not officially reported.

JURISDICTION

This appeal involves federal estate taxes. The date of death was July 31, 1958. (I-B R. 196.) The taxes and interest in dispute were paid as follows: \$90,000 on December 28, 1962 (I-B R. 200), and \$20,224.75 (of which \$17,555.17 represented interest), on February 18, 1963. (I-B R. 201.) Claim for refund was filed on November 12, 1963 (I-B R. 201), and was rejected on February 6, 1964 (I-B R. 201). Within the time provided in Section 6532 of the Internal Revenue Code of 1954, on September 28, 1964, the decedent's executor brought this action in the District Court for recovery of the tax and interest paid. (I-A R. 2-5.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346(a)(1). The judgment of the District Court was entered on January 13, 1966. (I-B R. 204.) Within sixty days thereafter, on February 11, 1966, a notice of appeal was filed. (I-B R. 207.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

QUESTION PRESENTED

The decedent bequeathed his residuary estate in trust with directions to the trustee to pay the income to his widow during her lifetime and, in its sole discretion, to use any part of the corpus "for expenses of accident, illness or other misfortune, or for any purpose whatsoever", and to pay any remaining

corpus (after intervening life estates to certain individuals) to named charities. The question is whether the District Court correctly held that the value of the charitable remainder as of the date of the decedent's death was not ascertainable by any reliable objective standard, and hence was not deductible for federal estate tax purposes under Section 2055(a) of the Internal Revenue Code of 1954, the applicable Treasury Regulations, and the controlling decisions of the Supreme Court.

STATUTES AND REGULATION INVOLVED

Internal Revenue Code of 1954:

SEC. 2055. TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES.

(a) *In General.*—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devices, or transfers (including the interest which falls into any such bequest, legacy, devise, or transfer as a result of an irrevocable disclaimer of a bequest, legacy, devise, transfer, or power, if the disclaimer is made before the date prescribed for the filing of the estate tax return)—

* * * *

(2) to or for use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty

to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

* * * *

For purposes of this subsection, the complete termination before the date prescribed for the filing of the estate tax return of a power to consume, invade, or appropriate property for the benefit of an individual before such power has been exercised by reason of the death of such individual or for any other reason shall be considered and deemed to be an irrevocable disclaimer with the same full force and effect as though he had filed such irrevocable disclaimer.

* * * *

(26 U.S.C. 1964 ed., Sec. 2055.)

Civil Code, 10 West's Annotated California Codes:

Sec. 2253. *Declaration of trust*

Declaration of trust. The nature, extent, and object of a trust are expressed in the declaration of trust.

Sec. 2254. *Declaration of trust; oral declarations; merger of previous declarations into written declaration*

Same. All declarations of a trustor to his trustees, in relation to the trust, before its acceptance by the trustees, or any of them, are to be deemed part of the declaration of the trust, except that when a declaration of trust is made

in writing, all previous declarations by the same trustor are merged therein.

Treasury Regulations on Estate Tax (1954 Code):

Sec. 20.2055-2 *Transfers not exclusively for charitable purposes.*

(a) *Remainders and similar interests.* If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the non-charitable interest. The present value of a remainder or other deferred payment to be made for a charitable purpose is to be determined in accordance with the rules stated in § 20.2031-7. Thus, if money or property is placed in trust to pay the income to an individual during his life, or for a term of years, and then to pay the principal to a charitable organization, the present value of the remainder is deductible. To determine the present value of such remainder use the appropriate factor from column 4 of Table I or Table II of § 20.2031-7, whichever is applicable. If the interest transferred is such that its value is to be determined by a special computation (see paragraph (e) of § 20.2031-7), a request for a specific factor, accompanied by a statement of the date of birth of each person the duration of whose life may affect the value of the remainder, and by copies of the relevant instruments, may be submitted by the executor to the Commissioner who may, if conditions permit, supply the factor requested. If the Commissioner does not furnish the factor, the claim

for deduction must be supported by a full statement of the computation of the present value made in accordance with the principles set forth in the applicable paragraph of § 20.2031-7.

* * * *

(26 C.F.R., Sec. 20.2055-2.)

STATEMENT

The material facts of this estate tax case are not disputed, and may be briefly summarized as follows:

Ludwig G.B. Erb (hereafter sometimes referred to as "decedent") died testate on July 31, 1958, at the age of 82. Decedent was survived by his widow, Emma Erb, who was 82 years old at the date of the decedent's death. The decedent had no children. (I-B R. 196.)

Decedent's will, which was duly probated in the Superior Court of Los Angeles County, named the Title Insurance and Trust Company as his executor. (I-B R. 196.) The executor will hereafter sometimes be referred to as "the bank".

Decedent's will, dated December 28, 1954, bequeathed the residue of his estate to the bank to be held by it as trustee under an inter vivos trust set up by decedent in April, 1942, for the uses and upon the terms specified in the inter vivos trust, as amended. (I-B R. 199.)

The inter vivos trust created by decedent in 1942 provided, in general, that the trust's income was to be paid to decedent during his life, and to Emma, his widow, should she survive him. Upon the death of

both decedent and Emma, after certain distributions from corpus, the income from the remaining corpus was to be distributed to certain named individuals, and, upon the death of such persons, the trust was to terminate and the corpus then existing was to be divided between six specified charitable institutions. (I-B R. 197.)

The inter vivos trust contained a provision whereby the trustee was authorized to invade the trust corpus on behalf of the decedent during his life, or his widow following his death. (I-B R. 197-198.) That provision, which is the basis of the present law suit, was amended on January 4, 1955 (three and a half years before decedent's death) to read as follows (I-B R. 198):

> If at any time or times during the life of this trust, the Trustor—and after his death, the said EMMA ERB, if she shall survive him—shall be in want of additional moneys for reasonable support, care and comfort, or for expenses of accident, illness or other misfortune, or for any purpose whatsoever, whether included in the foregoing classification or not; in such case of want or need, it shall be the duty of the Trustee, in its sole uncontrolled discretion, to pay to or to use or to apply or to expend for the said Trustor or EMMA ERB, his said wife, as the case may be, such portion or portions of the corpus of this trust estate, up to and including the whole thereof, as the Trustee may deem necessary to meet such want.

Pursuant to decedent's will, the residue of his estate was distributed to the inter vivos trust. This

residue was worth somewhat more than $705,000.00. (I-B R. 199.)

Emma Erb was a person of considerable personal means; her separate property yielded her an income ranging from a low of $26,190.87 in 1959 to a high of $36,080.95 for the eight-month period ending with her death on August 31, 1962. She was a person of modest tastes and frugal spending habits. She owned no valuable jewelry, and owned one $200 fur jacket. During the 49-month period in which she survived decedent, Emma saved $116,507.64 of her own separate income and income from the inter vivos trust, and spent $81,037.57. (I-B R. 199.) During that 49-month period there were no invasions of corpus on Emma's behalf, and the trustee's power to invade corpus terminated at her death. (I-B R. 200.)

On the decedent's federal estate tax return, timely filed on October 20, 1959, the bank claimed a charitable deduction for the value of the six charitable remainder interests in the amount of $297,562.71. This claimed deduction was disallowed, and a deficiency in federal estate tax of $92,669.58 was asserted. (I-B R. 200.) The deficiency (with interest) was then paid, and the bank filed a timely refund claim. Upon rejection of the refund claim the bank brought a timely suit for refund in the District Court (I-B R. 201.)

The case was pre-tried before Judge Harry C. Westover, and the Government then moved for summary judgment. (I-A R. 77.) The motion was opposed by the bank, with both sides filing extensive briefs. (I-A R. 79-91; I-A R. 96-100; I-B R. 101-

142.) The Government's motion was granted, with Judge Westover ruling in a memorandum of decision. (I-B R. 166-178.) Proposed findings of fact and conclusions of law in accordance with the memorandum of decision were prepared by both parties, and, after a hearing, findings of fact and conclusions of law were entered by the trial judge. (I-B R. 195-203.) Judgment was entered in favor of the Government on January 13, 1966 (I-B R. 204), and the bank then took this timely appeal.

SUMMARY OF ARGUMENT

The decedent in an inter vivos trust, through which the residue of his estate was to be administered, authorized his trustee in its sole uncontrolled discretion to invade the charitable remainders "for reasonable support, care and comfort, or for expenses of accident, illness or other misfortune, or for any purpose whatsoever, whether included in the foregoing classification or not" of his widow, the life beneficiary. Since the extent to which the charitable remainders might be diverted on behalf of the widow under this power of invasion was not susceptible of prediction by any reliable objective standard, the remainders had no ascertainable value as of decedent's death and accordingly were not deductible for federal estate tax purposes. No tenable distinction can be drawn between this case and *Henslee* v. *Union Planters Bank*, 335 U.S. 595, and *Merchants Bank* v. *Commissioner*, 320 U.S. 256, where the Supreme Court held that discretionary powers of the trustees to invade for more

limited purposes on behalf of the widow sufficed *per se* to defeat valuation and deduction of the charitable remainders because the existence of such powers injected elements of speculation too great to be overcome, notwithstanding the facts that the widow's previous manner of living was modest and her resources substantial. So too, in the present case, the widow's economical living habits and independent means could have no more relevancy than in *Merchants Bank* v. *Commissioner*, *supra*, or *Henslee* v. *Union Planters Bank*, *supra*.

These Supreme Court decisions have been followed in cases where the discretionary power to invade was even more restricted than that involved here. Furthermore, the California courts would not interfere with the trustee's discretionary power to invade, nor limit it to a more rigid standard, because to do so would disregard the plain language of the trust instrument and substitute the court's discretion for that of the trustee.

Under these circumstances, the District Court correctly held that the value of the charitable remainders failed to qualify for the charitable deduction, and its decision should be affirmed.

ARGUMENT

The District Court Correctly Held That the Trustee's Power to Invade Principal Was Not Limited by an Ascertainable Standard Capable of Being Stated in Definite Terms of Money, and That the Remainder Gifts to Charity Were Accordingly Ineligible for the Charitable Deduction Allowed by Section 2055(a) of the Internal Revenue Code of 1954

The factual background of this estate tax case is undisputed. The sole issue is whether the value of remainder interests in a trust of the decedent's residuary estate qualifies for the deduction allowed for charitable bequests by Section 2055(a) of the 1954 Code, *supra*, and the applicable Treasury Regulations.

Section 2055(a) of the 1954 Code provides for the deduction from the gross estate of a decedent of the amount of all bequests to or for the use of qualified charities. While there is no question in this case that there was a bequest in trust for qualified charities, nevertheless the issue arises as to whether the amount of the bequests was sufficiently ascertainable at the date of the decedent's death to permit the deduction. In this connection, the long standing applicable regulation (Treasury Regulations on Estate Tax (1954 Code), Section 20.2055-2(a), *supra*) provides that if a trust is created for both a charitable and a private purpose, deduction may be taken for the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the non-charitable interest. It is the position of the Government, sustained by the court below, that the value of the charitable beneficial

interest bequeathed by the decedent was not ascertainable at the date of the decedent's death within the meaning of the Code and the Regulations, and the controlling Supreme Court decisions, and therefore the claimed deduction must be denied.

The reason why the value of the charitable remainders could not be determined as of the date of decedent's death is that he gave his trustee extremely broad powers to invade principal in favor of his widow, the life beneficiary, and the purposes for which the widow could and might wish to have the funds spent did not lend themselves to reliable prediction. In other words, there was no ascertainable standard provided for in the trust instrument by which to determine the extent of the trustee's power to invade corpus of the trust for the decedent's widow. See *Merchants Bank* v. *Commissioner*, 320 U.S. 256; *Henslee* v. *Union Planters Bank*, 335 U.S. 595; cf. *Ithaca Trust Co.* v. *United States*, 279 U.S. 151.

Decedent's will provided that his residuary estate was to be poured over into an inter vivos trust which he had created 16 years before his death. His widow, Emma, was to receive the trust's income for her life, and at her death the corpus of the trust was to be distributed in part to other individuals and upon the termination of life estates for certain named individuals the balance of the corpus was to be paid over to six charitable institutions. The pertinent provision of the trust is Section Six, which was amended about 3½ years before decedent's death to read as follows (I-B R. 198):

> If at any time or times during the life of this trust, the Trustor—and after his death the said EMMA ERB, if she shall survive him—shall be in want of additional moneys for reasonable support, care and comfort, *or for expenses of accident, illness or other misfortune, or for any purpose whatsoever, whether included in the foregoing classification or not;* in such case of want or need it shall be the *duty of the Trustee, in its sole uncontrolled discretion* to pay to or use or apply or to expend for the said Trustor or EMMA ERB, his said wife, as the case may be, *such portion or portions of the corpus of this trust estate, up to and including the whole thereof, as the Trustee may deem necessary to meet such want.* (Emphasis supplied.)

We submit that the above language of the trust instrument provides such broad standards for invasion of corpus as to make it impossible to determine, as of the decedent's death, the amounts, if any, which the charities would receive. The Supreme Court has explicitly held that no charitable deduction is allowable for bequests which may never reach charity, and that "Where the principal of a bequest to charity thus may be invaded for private purposes, it is only the ascertainable and assured balance of the bequest to charity that is recognized for a tax deduction." *Commissioner* v. *Sternberger's Estate*, 348 U.S. 187, 194. See also *Henslee* v. *Union Planters Bank, supra; Merchants Bank* v. *Commissioner, supra.*

A claimed charitable deduction of a remainder interest must pass two tests to be allowable. First, al-

though the possibility of actual invasion of corpus may be remote, it must be clear from the governing instrument that there is an ascertainable standard for invasion of corpus. Second, the extent of possible invasion must be measured in terms of money. Thus, in Paul, Federal Estate and Gift Taxation (1946 Supp.) pp. 436-437, the author states the governing rules as follows:

> Analysis of these invasion cases would be materially facilitated if two basic propositions were respected. First, if the power of invasion is not measurable in terms of an ascertainable standard, the deduction should fail regardless of any question of remoteness or imminence of invasion. This is the message of the Merchants National Bank case. Second, if some standard is ascertainable, the extent of possible invasion should be determined, and the residue allowed as a deduction. In short, the lack of remoteness should not necessarily bar the deduction *in toto*. Exact computation in each case is, of course, out of the question. While tax law at times satisfies itself with "a rough estimate" and "an approximation derived from the evaluation of elements not easily measured", the Supreme Court apparently requires a greater degree of accuracy for purposes of the charitable deduction. These two propositions obviously leave open the critical question whether the life tenant's claim to principal is confined by some ascertainable standard. And at this point the only generality that one can offer is that no ready touchstone is available which conveniently reveals the answer. There is no limit to the imagination of draftsmen and such

> words as "happiness", "need", "welfare", and "desire" must be read with a close eye to the background. But the Government may fairly assert that he who claims an ascertainable standard should produce "clear and convincing proof" that local law enforces such a standard. Although Congress has generously granted a deduction, it is not too much to ask that the estate clearly establish its right thereto.

See, also, 4 Mertens, Law of Federal Gift and Estate Taxation (1959), pp. 397-398, where the author says:

> Where receipt by the charity of its interest is subject to a power of invasion for the benefit of private persons, the determination as to whether any portion of such interest is assured is controlled primarily by two subordinate tests: (1) whether by the terms of the trust or other instrument of transfer the trustee's or beneficiary's power of invasion is limited by definite and ascertainable fixed standards capable of being stated in terms of money (such standard must, in the first instance, be determined by reference to the will); and (2) whether the extent of anticipated invasions, as of the time of the transfer in trust, and the effect thereof on the present value of the power of invasion, under the circumstances, is clearly demonstrable. The second requirement cannot stand independently of the first; if there is not a qualifying fixed standard the deduction is not allowed irrespective of the probability or improbability of actual invasion for private use. Conversely, once the fixed standard is established, the second test will show whether it is possible to factually establish the

> portion which is assured to the charity as free from the contingency of invasion for private use.

And see, Lowndes and Kramer, Federal Estate and Gift Taxes (1962 ed.), p. 483; Note, Deduction of a Charitable Remainder, 41 Va. L. Rev. 635, 648 (1955); *Merchants Bank* v. *Commissioner*, *supra*, pp. 261-263; *Henslee* v. *Union Planters Bank*, *supra*, pp. 599-600.

In short, the first test which a claim for a charitable deduction for a remainder interest must pass is that of determining whether the supervening power to invade corpus is sufficiently limited by an ascertainable standard as to make the remainder severable from the private life estate. A bequest which passes this test assures that the charity will take *something*, but this does not establish *how much* the charity will ultimately receive. That latter question brings the second test into play; if the standard for invasion is ascertainable, what are the chances of invasion actually occurring? If the power to invade does not pass the first test (ascertainable standard), the second test (determination of amount) is never reached. *Merchants Bank* v. *Commissioner*, *supra*; *Newton Trust Co.* v. *Commissioner*, 160 F. 2d 175, 178-180 (C.A. 1st, 1947); *Merrill Trust Co.* v. *United States*, 167 F. Supp. 474 (D. Me., 1958).

The law has now become well-settled that it is the existence of the power to invade corpus, and not the likelihood of its exercise, which governs. The Supreme Court phrased the rule thus in *Henslee* v. *Union Planters Bank*, *supra*, p. 599:

> But, though there may have been little chance of that extravagance which would waste a part or consume the whole of the charitable interest, that chance remained. What common experience might regard as remote in the generality of cases may nonetheless be beyond the realm of precise prediction in the single instance.

The bequest in that case (p. 596) allowed the trustees "to use and expend in their discretion any portion of my estate, either income or principal, for the pleasure, comfort and welfare of my mother." The decedent's mother was 85 years old at the time of his death, had no dependents, lived moderately, and died three years after her son without ever seeking to invade corpus. She had a private income of $3,600 per year, and the trust set up by decedent to pay her $9,000 per annum in fact earned $15,000 per annum. Although the Supreme Court recognized that on these facts the likelihood of actual invasion of corpus was very small, the charitable deduction was denied because there was no ascertainable standard set forth to govern invasion of corpus and the charitable remainder was not severable from the private life estate. The rule of that case is, we submit, equally applicable and controlling here.

The issue in the present case is thus narrowed to the question of whether the terms of Section Six of decedent's trust supplied an ascertainable standard governing the trustee's power to invade corpus which was capable of being stated in terms of money. There is no real dispute here that actual invasion of the corpus was unlikely, considering Mrs. Erb's age, pri-

vate income and modest personal living habits,[2] but that goes to the second test of amount; we submit that before ever reaching an inquiry as to the likelihood of invasion the ascertainable standard must be present, and Section Six manifestly contains no such standard.

The critical language of Section Six is that which allows the trustee, in its sole uncontrolled discretion, to expend up to the entire amount of the corpus of the trust "for reasonable support, care and comfort, or for expenses of accident, illness or other misfortune, or for any purpose whatsoever, whether included in the foregoing classification or not". This language is clear and unambiguous; it conveys an exceptionally broad power of invasion. When it is contrasted with trust language which has been held to supply an ascertainable standard in other cases, it becomes readily apparent that it fails to meet the first test for deductibility.

In *Ithaca Trust Co.* v. *United States*, *supra*, p. 154, the trust provided that corpus could be invaded for any sum "necessary to suitably maintain her [the life beneficiary] in as much comfort as she now enjoys." This, the Supreme Court held (p. 154), created an ascertainable standard, being "fixed in fact and capable of being stated in definite terms of money." Notwithstanding the obvious disparity between the language of Section Six of decedent's trust and that of the *Ithaca Trust* case, it is apparent that the affida-

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[2] See Finding of Fact XII (I-B R. 199) of the court below as to Emma's Resources and living habits.

vits of decedent's attorney and the trust officer to the effect that Section Six was meant to allow invasion only to maintain Mrs. Erb's living standard (I-B R. 143-146, 150-151) are simply after-the-fact attempts to fit the language of Section Six within the rubric of the *Ithaca Trust* holding.[3]

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[3] Other cases in which an ascertainable standard limiting invasion of corpus has been found include *Hartford-Connecticut Trust Co.* v. *Eaton,* 36 F. 2d 710 (C.A. 2d, 1929), where corpus could be invaded for amounts the trustee "may deem necessary or advisable for * * * [the life beneficiary's] comfortable maintenance and support" (p. 710) ; *Lucas* v. *Mercantile Trust Co.,* 43 F. 2d 39 (C.A. 8th, 1930), where invasion was authorized for amounts "necessary for the comfort, maintenance and support" of the life beneficiary (p. 40) ; *Berry* v. *Kuhl,* 174 F. 2d 565 (C.A. 7th, 1949), in which the will allowed invasion of corpus (up to $5,000 per year) "If by reason of accident, illness or other cause * * * [the life beneficiary] requires funds for this treatment, support or maintenance * * *" (p. 566) ; *Lincoln Rochester Trust Co.* v. *McGowan,* 217 F. 2d 287 (C.A. 2d, 1954), where corpus would be invaded for such sums "as * * * may be necessary to meet any unusual demands, emergencies, requirements or expenses for * * * [the life beneficiary's] personal needs", and the will further provided, "This clause is intended to provide for emergencies arising from sickness, accident or failure of investments" (p. 289). In *Bowers* v. *South Carolina National Bank of Greenville,* 228 F. 2d 4 (C.A. 4th, 1955), the will allowed corpus to be expended to pay all expenses of keeping up a house and all necessary medical and hospital expenses of the beneficiary; this was held to be an ascertainable standard, as was the language involved in *United States* v. *Powell,* 307 F. 2d 821 (C.A. 10th, 1962), wherein the trust authorized invasion of principal for the "maintenance, welfare, comfort, or happiness" of the grantor's wife or daughters. In the *Powell* case, supra, the Court of Appeals held that under applicable local law (that of Kansas), "happiness" was synonymous with "welfare" and "comfort", and this would be a fixed standard under *Ithaca Trust, supra.*

In *Merchants Bank* v. *Commissioner*, *supra*, p. 258, the testator bequeathed the corpus of a testamentary trust to charities and empowered the trustee in its discretion to invade the corpus "for the comfort, support, maintenance, and/or happiness" of the life beneficiary, his widow. The Supreme Court sustained the long-standing Treasury Regulations *(supra)* which provide that a charitable bequest is deductible only in so far as it has a "presently ascertainable" value as of the testator's death. Distinguishing *Ithaca Trust*, it held that the extent to which the charitable remainder might be diverted to the widow was not measurable by any reliable objective standard. The mere existence of the invasionary power sufficed to defeat the deduction because (320 U.S. p. 263) "Introducing the element of the widow's happiness * * * brought into the calculation elements of speculation too large to be overcome, notwithstanding the widow's previous mode of life was modest and her own resources substantial."

The test applied by the Supreme Court in *Merchants Bank* was the same as that underlying its decision in *Ithaca Trust;* the difference in result stemmed from a vital difference in the nature of the invasionary power.

In *Union Planters Bank*, the Supreme Court, on the authority of its *Merchants Bank* decision, held (p. 596) that the power of the trustees to invade the corpus of the trust for the "pleasure, comfort and welfare" of the life beneficiary, the testator's mother, precluded deduction of the charitable remainder not-

withstanding the unlikelihood of the exercise of the invasionary power.

The charitable remainder in this case was no more susceptible of reliable measurement than those denied deduction by the Supreme Court in the *Merchants Bank* and *Union Planters Bank* cases. Indeed, the instant case presents an *a fortiori* situation for denial of the deduction, since the invasionary power which the decedent here granted to the trustee ("for any purpose whatsoever") was even broader than the powers involved in those cases.

The two cases decided by this Court which the bank here emphasizes in its brief (pp. 20-24), involved invasionary powers very different from those granted in Section Six of decedent's trust in issue here. Thus in *Commissioner* v. *Bank of America, Etc.*, 133 F. 2d 753 (C.A. 9th, 1943), the trustee was authorized to invade corpus for the beneficiary "in case she should, by reason of accident, illness, or other unusual circumstances so require", and the trustee's power was further restricted to "such additional sum or sums as in the judgment of said trustee may be necessary and reasonable under the existing conditions." This case was shortly followed by *Commissioner* v. *Wells Fargo B. & U. Tr. Co.*, 145 F. 2d 130 (C.A. 9th, 1944), where corpus could be used by the trustee to assist the beneficiary in case of need "on account of any sickness, accident, want or other emergency."

The most important fact about the *Wells Fargo* and *Bank of America* cases, *supra*, however, is that they were both decided before the Supreme Court de-

cided *Henslee* v. *Union Planters Bank, supra.* The *Bank of America* case was decided in 1943, and the *Wells Fargo* case in 1944; *Henslee* v. *Union Planters Bank* was decided in 1948, and *Merchants Bank* v. *Commissioner,* which it followed, was decided in 1943.

It is apparent that the invasionary powers contained in Section Six of the Erb trust are far more sweeping and far less restrictive than those which have previously failed the ascertainable standard test. In *Henslee* v. *Union Planters Bank, supra,* a power to invade for the "pleasure, comfort and welfare" of the life beneficiary was held insufficiently ascertainable. In *Merchants Bank* v. *Commissioner, supra,* p. 30 invasionary power for the "comfort, support, maintenance, and/or happiness" of the life beneficiary was also held insufficiently ascertainable. In *Gammons* v. *Hassett,* 121 F. 2d 229, 230 (C.A. 1st, 1941), certiorari denied, 314 U.S. 673, corpus could be invaded "as my said wife may at any time and from time to time need or desire"; this failed the ascertainable standard test, as did the language of *Newton Trust Co.* v. *Commissioner, supra,* where corpus could be expended for the beneficiary's "use and benefit". This was also the result in *Zentmayer's Estate* v. *Commissioner,* 336 F. 2d 488 (C.A. 3d, 1964), where (p. 489) the corpus could be spent "for the purpose of the support, the maintenance, the welfare and comfort of * * * [the beneficiary], and for any other purpose which * * * [the] trustees shall deem expedient, necessary or desirable for the benefit or use of * * * [the beneficiary]." Again, in *De Castro's Estate* v. *Commissioner,* 155 F. 2d 254 (C.A.

2d, 1946), the Second Circuit found the standard too vague where (p. 255) corpus could be invaded "if, during the life of my wife * * * due to her illness, accident or other unforseen emergency, the income of the two (2) trusts shall not be sufficient to amply provide for her needs". See also *Merrill Trust Co.* v. *United States*, *supra*.

A comparison of the language of Section Six of the Erb trust, authorizing invasion of corpus for "reasonable support, care and comfort, or for expenses of accident, illness or other misfortune, or for any purpose whatsoever, whether included in the foregoing classification or not", with that presented in *State Street Bank & Trust Co.* v. *United States*, 313 F. 2d 29 (C.A. 1st, 1963), likewise compels the conclusion that Section Six sets forth no ascertainable standard. In that case (p. 29), invasion was authorized for the beneficiary's "comfortable support and maintenance and for any other reasonable requirement." The Court of Appeals held (p. 31) that the "any other reasonable requirement" language rendered the standard unascertainable; it "authorized the trustees to provide something more; to wit, a higher—and hence immeasurable—standard."

Language strikingly similar to that of Section Six was considered in *James* v. *Commissioner*, 40 T.C. 494 (1963). There the will authorized the trustees to pay any part of the trust corpus (p. 496) "for the account of any beneficiary either for comfortable maintenance and support, for educational requirements, illness, operations, or for any reason whatsoever

which shall to my Trustees, in their sole discretion, seem sufficient." The Tax Court held the power of invasion to be so broad, and so far in excess of maintenance of the beneficiary's prior living standard, as not to constitute an ascertainable standard. It rejected the taxpayer's contention that "any reason whatsoever" was limited by the preceding specific terms. The bank in the present case makes precisely the same argument (Br. 36), which should also be rejected here. See also *Marine Trust Co. of Western New York* v. *United States*, 247 F. Supp. 278, 280 (W.D. N.Y., 1965). Indeed, in the present case this result follows *a fortiori*, because Section Six explicitly provides that invasion could be made for "any purpose whatsoever, whether included in the foregoing classification or not". The language chosen by decedent could scarcely have been clearer.

Other arguments advanced by the bank in an effort to construe the language of Section Six as supplying an ascertainable standard are equally untenable. In the first place, the fact that the invasion of corpus was to be exercised in a fiduciary capacity by a corporate trustee does not somehow confer ascertainability on the power to invade; in almost all the cases on the subject the power to invade was exercisable by a fiduciary, whose standing as such does not create an ascertainable standard where none existed under the instrument. *Strite* v. *McGinnes*, 215 F. Supp. 513, 515-516 (E.D. Pa., 1963). Further, the trust officer who averred that he would not have invaded corpus except to maintain Mrs. Erb's standard of living

would have been acting in conflict with the express terms of the trust, and it is the law in California that a trust created by a written instrument cannot be varied by subsequent declarations of the trustee. *Bowling* v. *Newlands*, 112 Cal. 476, 44 Pac. 810 (1896). By the same token, there is no merit to the bank's contention that the meaning of Section Six as it now stands, following its amendment in 1955, can be altered by referring back to its original provisions. (Br. 31-33.) The California Civil Code, in Section 2254, *supra*, states explicitly that "when a declaration of trust is made in writing, all previous declarations by the same trustor are merged therein."

Finally, the bank argues at length that, under California law, the power here to invade corpus would be restricted to amounts needed to support Mrs. Erb in her accustomed manner, and that this power would have to be exercised in the light of her other available income from non-trust sources. (Br. 25-36.) California law, however, does not support these contentions. In the first place, although a trust for the benefit of third persons may be created in California for any purpose for which a contract may be made (California Civil Code, Section 2220), that rule has no relevance to the narrow issue raised here. The case of *Ringrose* v. *Gleadall*, 17 Cal. App. 664, 667 (1911), cited by the bank (Br. 32) for the proposition that the trust here must be construed under principles of contract law, recites this proposition as mere *obiter dictum*—and no California case has been found in which it has been repeated. Indeed, the

holding of the *Ringrose* case is that nothing can be read into a trust instrument not already there. We submit that in the present case the California courts would determine the decedent's intent from the four corners of the trust instrument alone—not from after-the-fact affidavits of attorneys or trust officers, or from the superseded terms of previous trust provisions. California Civil Code, Sections 2253, 2254, *supra; Lombardi* v. *Blois*, 230 Cal. App. 2d 191, 40 Cal. Rptr. 899 (1964); *Estate of Patten*, 217 Cal. App. 2d 167, 31 Cal. Rptr. 767 (1963); *Warner Estate*, 183 Cal. App. 2d 846, 7 Cal. Rptr. 319 (1960); *Heifetz* v. *Bank of America*, 147 Cal. App. 2d 776, 305 P. 2d 979 (1957); *Union Nat. Bank* v. *Hunter*, 93 Cal. App. 2d 669, 209 P. 2d 621 (1949); *Security First Nat. Bank* v. *Wellslager*, 88 Cal. App. 2d 210, 198 P. 2d 700 (1948); *Smith* v. *Bank of America, Etc. Assn.*, 14 Cal. App. 2d 78, 57 P. 2d 1363 (1936). The terms of Section Six of decedent's trust impose no restriction on invasion of corpus limiting such invasion to amounts needed to maintain Mrs. Erb's standard of living, and the California Courts would not engraft such a restriction thereon. As the California Supreme Court made clear in *Moxley* v. *Title Ins. & Trust Co.*, 27 Cal. 2d 457, 463, 165 P. 2d 15, 18 (1945):

> It is axiomatic that we must look to the instrument creating the trust to determine the nature, extent and object of said trust.

Contrary to the bank's assertion (Br. 26, 34-35), we do not maintain that the trustee here has *carte*

blanche to invade corpus for any whim of the beneficiary, or for patently unreasonable purposes. The California courts do not allow a trustee to exercise a wholly unlimited discretion, or an arbitrary one; a trustee must, ordinarily, exercise a "reasonable judgment". This means, primarily, that the trustee must adhere to the standards set up by the trustor, and act to effectuate the trustor's purpose in creating the trust—looking principally at the trust document itself to determine the trustee's rights. *Estate of Miller*, 230 Cal. App. 2d 888, 907-909, 41 Cal. Rptr. 410 (1964). However, where—as here—the trustee may invade corpus in its "sole uncontrolled discretion", even the "reasonable judgment" standard has been waived by the trustor. As was held in *Coberly v. Superior Court*, 231 Cal. App. 2d 685, 689, 42 Cal. Rptr. 64, 66 (1965):

> A grant of absolute discretion to a trustee to administer assets does not mean it can do as it pleases, but rather that the grantor has waived the requirement that the conduct of the trustee at all times satisfy the standard of judgment and care exercised by a reasonable, prudent man.
> * * *

In addition, the bank maintains that California law would not permit invasion of corpus for Mrs. Erb unless her other available income proved inadequate to meet her needs. (Br. 29-30.) Since Mrs. Erb was a person of substantial personal wealth, the bank in substance argues that this outside income makes the standard of invasion set forth in Section

Six an ascertainable one. The California law on this point, however, hinges on the factual question of whether the trustor intended to make a gift to the beneficiary regardless of the beneficiary's other means. Thus in *Estate of Ferrall*, 41 Cal. 2d 166, 176, 259 P. 2d 1009, 1014 (1953), where invasion of corpus was permitted "to meet the needs" of the life beneficiary, the Court held that the trustee should consider such needs "unless the language of the trust instrument affirmatively reveals an intention to make a gift * * * regardless of the beneficiary's other means".

In the present case the trustee not only had power to invade corpus under a standard far broader than "to meet the needs" of the beneficiary, but the trust instrument affirmatively reveals an intention to benefit Mrs. Erb without regard to her personal resources. Moreover, cases of the *Ferrall* type are poor vehicles from which to draw general principles or arbitrary rules. See, for example, the exhaustive survey of this area in Halbach, Problems of Discretion in Discretionary Trusts, 61 Colum. L. Rev. 1425, 1442-1449 (1961). The author characterizes the facts in the *Ferrall* case as "easy" (p. 1431, fn. 36); the facts of the present case are quite different. In any event, if the bank took the position in a state court proceeding that it did not have power to invade corpus if Mrs. Erb's outside income was adequate for the purpose at hand, it would have to overcome the rule of the Restatement of Trusts (Second), Section 128, comment (e) (1959), which provides:

> It is a question of interpretation whether the beneficiary is entitled to support out of the trust fund even though he has other resources. The inference is that he is so entitled.

The case of *Di Maria* v. *Bank of California*, 237 Cal. App. 2d 327 (1965), cited by the bank (Br. 30), is completely inapplicable here. In the *Di Maria* case (p. 329, fn. 1) invasion of corpus was authorized for the beneficiary's "reasonable support, medical care and comfort", and invasion was to be based on "income which the Trustor has from other sources" as well as trust income both being insufficient. Perhaps the most that can be said for the bank's argument on this facet of the case is that it might be able to convince a California court that it should not invade corpus until Mrs. Erb's other income was at least jeopardized—but that will not do insofar as supplying the ascertainable standard for purposes of a federal estate tax deduction. *Merchants Bank* v. *Commissioner, supra; Henslee* v. *Union Planters Bank, supra.*

It is difficult to perceive the point of the bank's contention (Br. 28) that decedent's concern for the charitable remaindermen was so great that he voluntarily eschewed the marital deduction rather than give his widow a power of appointment over one-half of his residuary estate. If Ludwig Erb's sentiments for the charities were strong enough, he could simply have made outright bequests to them—and this litigation would never have arisen. All that the bank's argument proves is that decedent cared neither for

the marital nor the charitable deductions afforded by the federal estate tax law; he wanted to have his will (and trust) drawn his way, so as to benefit his wife —even to the extent of authorizing provision of the trust corpus for her benefit "for any purpose whatsoever"—and tax-saving considerations were apparently secondary. (See, for example, the affidavit of decedent's attorney as to his client's sentiments about tax-saving suggestions (I-B R. 143-145; Br. 6-7).)

Finally, the bank argues that invasion to maintain Emma's accustomed standard of living would constitute an ascertainable standard. (Br. 37-40.) We have no quarrel with the proposition, drawn as it is from many of the cases discussed *supra*. The important point for purposes of the present case is that invasion of corpus under Section Six of decedent's trust was not limited to maintaining Emma's living standard, nor would local law so limit invasion. The bank's argument chooses to ignore the language of the trust itself, and the instrument leaves little room for doubt but that decedent wanted the trustee to invade corpus if necessary to satisfy any reasonable desire his widow might have. There is no adequate basis whatever to assume that he would restrict her in any way to enhance his charitable contributions, which were obviously less important to him than the interests of his widow.

The bank's Conclusion (Br. 41-43) constitutes an *ad hominem* attack on the Government, and merits no response. At any rate, the Supreme Court, in *Henslee* v. *Union Planters Bank*, *supra*, p. 600, has

explicitly disposed of the contention that because invasion did not in fact occur the standard for invasion was ascertainable at the date of decedent's death:

> Nor do we think it significant that the trust corpus was intact at the mother's death, for the test of present ascertainability of the ultimate charitable interest is applied "at the death of the testator". *Ibid.* The charitable deduction is a matter of congressional grace, and it is for Congress to determine the advisability of permitting amendment of estate tax returns at such time as the probable vesting of the charitable interest has reduced itself to unalterable fact.

CONCLUSION

The District Court's decision is correct, and should be affirmed.

Respectfully submitted,

MITCHELL ROGOVIN,
Assistant Attorney General.

LEE A. JACKSON,
HARRY BAUM,
JONATHAN S. COHEN,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

Of Counsel:

MANUEL L. REAL,
United States Attorney.

LOYAL E. KEIR,
Assistant United States Attorney.

SEPTEMBER, 1966.

Certificate

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: ______________ day of ______________, 1966.

____
Attorney

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No. 20843

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Title Insurance and Trust Company, Executor of the Estate of Ludwig G. B. Erb, Deceased,

Appellant,

vs.

The United States of America,

Appellee.

On Appeal From United States District Court for the Southern District of California, Central Division.

APPELLANT'S REPLY BRIEF.

Bodkin, Breslin & Luddy,
Henry G. Bodkin, Jr.,
Harry A. Olivar,
4201 Wilshire Boulevard,
Suite 400,
Los Angeles, Calif. 90005,
Attorneys for Appellant.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

TOPICAL INDEX

Page

Preliminary statement 1

I.

The language of the trust instrument in the light of the substantive law of California, provides a sufficiently definite standard limiting the power of invasion 2

A. The extent of the power invasion, that is, the factor which determines if there is an ascertainable standard, must be decided under California law 5

B. The federal cases cited by appellee in support of its position that no ascertainable standard has been created by the instant trust are readily distinguishable on their facts 7

C. Although an ascertainable standard should be discernible from the plain meaning of the trust if compared to prior federal decisions, interpretation of the trust under state law compels the conclusion that the trustee is limited in its power of invasion to the maintenance of the standard of living which the life beneficiary had enjoyed at the time of decedent's death 16

II.

A reading of the interpretative regulations of the treasury department discloses that the regulations themselves are inconsistent with appellee's position 23

Conclusion 28

TABLE OF AUTHORITIES CITED

Cases — Page

Bowers v. South Carolina Natl. Bk., 228 F. 2d 4 27

Brock v. Hall, 33 Cal. 2d 885 18

Coberly v. Superior Court, 231 Cal. App. 2d 685 .... 19, 20

Commissioner v. Robertson's Estate, 141 F. 2d 855 .. 27

Commissioner v. Sternberger's Estate, 348 U.S. 187 8

Commissioner v. Wells Fargo Bank, 145 F. 2d 130 .. 26

De Castro's Estate v. Commissioner, 155 F. 2d 254 .... 10, 11

Ferrall, Estate of, 41 Cal. 2d 166 .... 21, 22

Gammons v. Hassett, 121 F. 2d 229, cert. den. 314 U.S. 673 .... 6, 9

Harris, H. M., Estate of, 23 T.C. Memo 1965 3

Hartford-Connecticut Trust Co. v. Eaton, 36 F. 2d 710 6

Helvering v. Winmill, 305 U.S. 79 24

Henslee v. Union Planters Bank, 335 U.S. 595 .... 7, 26

Ithaca Trust Co. v. United States, 279 U.S. 151 8

James v. Commissoner, 40 T.C. 494 .... 5, 11

Lincoln Rochester Trust Co. v. McGowan, 217 F. 2d 287 .... 3, 26

Lombardi v. Blois, 230 Cal. App. 2d 191 17

Marine Trust Co. of Western New York v. U.S., 247 F. Supp. 278 11

Merchants Bank v. Commissioner, 320 U.S. 256 7

Merrill Trust Co. v. U.S., 167 F. Supp. 474 9

Newton Trust Co. v. Commissioner, 160 F. 2d 175 .. 8

Randall v. Bank of America, 48 Cal. App. 2d 249 .... 18, 27

Raymond, Estate of, 96 Cal. App. 2d 808 18

Page

State Street Bank & Trust Co. v. U.S., 207 F. Supp. 955 11

State Street Bank & Trust Co. v. U.S., 313 F. 2d 29 3

Strite v. McGinnes, 215 Fed. Supp. 513 6

Union Nat. Bk. of Clarksburg v. Looker, 14 AFTR 2d 6208 3

United States v. Powell, 307 F. 2d 821 .... 3, 6

Wood, Estate of, 39 T.C. 919 28

Zentmayer's Estate v. Commissioner, 336 F. 2d 488 .... 9, 10, 28

Regulations

Treasury Regulations, 105, Sec. 81.46 8

Treasury Regulations, Sec. 20.2055-2 .... 3, 4, 23

Treasury Regulations, Sec. 20.2055-2(a) 5

Treasury Regulations, Sec. 20.2055-2(b) 8

Statutes

Code of Civil Procedure, Sec. 1856 16

Internal Revenue Code, Sec. 2055 4

Textbooks

4 Mertens, Law of Federal Gift and Estate Taxation (1959), p. 397 14

Paul, Federal Estate and Gift Taxation (1946 Supp.), p. 436 4

Paul, Federal Estate and Gift Taxation (1946 Supp.), p. 437 .... 4, 5

Restatement of Trusts, Second, Sec. 128, Comment (e) 22

Restatement of Trusts, Second, Sec. 187(j) 19

2 Scott on Trusts (2d ed.), p. 828 17

Witkin, California Evidence, pp. 397-421, 413 16

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On Appeal From United States District Court for the Southern District of California, Central Division.

APPELLANT'S REPLY BRIEF.

Preliminary Statement.

Appellee in its Brief filed with this court continues to confine its argument to the single proposition that the decision must be based upon a consideration of two phrases contained in Section Six (the power of invasion clause) of the Erb Trust. Complete reliance is placed upon the granting to the trustee of "sole, uncontrolled discretion" and the "lily-gilding" words "or for any purpose whatsoever."

Ignored is the part these phrases play in the overall meaning of Section Six or the intention of the trustor generally as it appears from the total trust instrument and from the uncontradicted extrinsic evidence. Overlooked is our observation that Appellee's interpretation of the language of the invasion clause creates an ambiguity where it otherwise does not exist.

I.

The Language of the Trust Instrument in the Light of the Substantive Law of California, Provides a Sufficiently Definite Standard Limiting the Power of Invasion.

Appellee's sole argument in its answering Brief is the same argument that erroneously persuaded the lower court to grant the government's Motion for Summary Judgment. Appellee urges that decedent directed the trustee ". . . in its sole uncontrolled discretion . . ." to use any part of the corpus "for expenses of accident, illness or other misfortune or for any purpose whatsoever." See "Question Presented" and "Summary of Argument." (Govt. Br. pp. 2, 9.) Appellee further argues that the extent of the corpus ". . . that might be diverted on behalf of the widow under this power of invasion was not susceptible of prediction by any reliable objective standard. . . ." (Govt. Br. p. 9.)

The thrust of the government's "reasoning" is that the specific language "or for any purpose whatsoever" creates a discretionary power in the trustee to invade the corpus which is broader than any power found in the decisions which have held for the government. The government's and the lower court's theory is simply erroneous.

There is a myriad of federal estate tax cases involving the question of whether a charitable remainder is deductible where the corpus was subject to a power of invasion. Unlike various other areas of substantive law,

there has been no appreciable development of guidelines as to what "interest is presently ascertainable" in the language of Treasury Regulations §20.2055-2. The courts that have concentrated on the "crucial" language creating the standard of invasion have held in some cases for the taxpayer and in others for the government. See, for example, *United States v. Powell,* 307 F. 2d 821 (C.A. 10th, 1962) holding that "maintenance, welfare, comfort, or *happiness*" constitutes an ascertainable, judicially enforceable standard; *Estate of H. M. Harris,* 23 T.C. Memo 1965, 109, declaring that "support, comfort and happiness" does not constitute an ascertainable standard. In some instances language which would seem to create an ascertainable standard ("for the comfortable support and maintenance and for any other reasonable requirement") has not secured the deduction. *State Street Bank & Trust Co. v. U.S.,* 313 F. 2d 29 (C.A. 1st, 1963). Language which would seem to create too broad a power of invasion ("to meet any unusual demands, emergencies, requirements or expenses") has resulted in a judgment for the taxpayer. *Lincoln Rochester Trust Co. v. McGowan,* 217 F. 2d 287 (C.A. 2d, 1954). See also *Union Nat. Bk. of Clarksburg v. Looker,* 14 AFTR 2d 6208, ... F. Supp. .... (D.C. W. Va., July 21, 1964), which found for the taxpayer even though the corpus could be invaded "to meet any emergency which shall arise from illness, misfortune, or other unusual condition."

Obviously there is an inherent difficulty with the governing federal statute and Regulation involved. I.R.C. §2055; Reg. §20.2055-2. This difficulty has created a hodgepodge of cases which litigants must look to as precedents. For this reason, we limited our discussion in our Opening Brief to the Supreme Court and Ninth Circuit decisions for the purpose of giving this court the judicial background of this much litigated question. The government has seen fit to assert that the words ". . . or for any other purpose whatsoever . . ." contained in the trust before this court "are far more sweeping and far less restrictive than those which have previously failed the ascertainable standard test." (Govt. Br. p. 22.) In addition to "comparing" two Supreme Court decisions, the government in an extremely limited manner sets out portions of the language of various decisions in which the courts have found for the government.

Each of the estate tax cases cited by the government in support of its position is distinguishable from the instant case for two reasons. First, none of those cases interpreted trusts under California law. Second, none of the cases present sufficiently comparable factual situations to be determinative here. It may be fairly concluded, although not stated in previous decisions, that most cases in the area of charitable deductions where a power of invasion is involved must be decided on an individual basis. "At this point the only generality that one can offer is that no ready touchstone is available which conveniently reveals the answer." (Paul, Federal Estate and Gift Taxation (1946 Supp.), pp. 436-437.)

A. The Extent of the Power Invasion, That Is, the Factor Which Determines if There Is an Ascertainable Standard, Must Be Decided Under California Law.

Appellee states, after the major portion of its Brief discusses the federal enactments and judicial decisions related to the issue before this court, that finally appellant "argues at length that, under California law, the power here to invade the corpus would be restricted to amounts needed to support Mrs. Erb in her accustomed manner, and that this power would have to be exercised in the light of her other available income from non-trust sources." (Govt. Br. p. 25.) We must point out to the court and to appellee that this is not an "additional" argument that we have added to our discussion of the Supreme Court and Ninth Circuit cases. It is clear that in determining whether an "interest is presently ascertainable" within the meaning of Treasury Regulations §20.2055-2(a), that the law of the state in which the trust is administered is controlling. *James v. Commissioner*, 40 T.C. 494, a Tax Court decision relied upon by appellee, points this out in stating that the remainder interest left to the charity "does not have a value which is capable of determination *unless the trustees are limited* in their invasion of the trust principal by some ascertainable standard." (Emphasis added.) Whether the trustees are so limited herein depends both upon the terms of the trust and California law.

Quotations from other authorities cited by appellee in support of its position follows:

> ". . . he who claims an ascertainable standard should produce 'clear and convincing proof' that local law enforces such a standard."
>
> (Paul, Federal Estate and Gift Taxation (1946 Supp.) p. 437.)

"The extent of the decedent's interest in her sisters' estates under the power to consume must be determined by Pennsylvania law. The taxability of the interest as so established will be determined by Federal Law . . . (Citations.)"

(*Strite v. McGinnes*, 215 Fed. Supp. 513, 515.)

"The will must be interpreted under Massachusetts law. 'State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed.' (Citation.)"

(*Gammons v. Hassett*, 121 F. 2d 229, 231 (C.A. 1st, 1941), certiorari denied, 314 U.S. 673.)

It should be further noted that two of the cases cited in footnote three of Appellee's Brief on page 19 held that the power to invade the corpus was limited by local law and found for the taxpayer. The court in *Hartford-Connecticut Trust Co. v. Eaton*, 36 F. 2d 710 (C.A. 2d, 1929), stated: ". . . the question depends upon how the courts of Connecticut interpret such a provision." *United States v. Powell*, 307 F. 2d 821, 828 (C.A. 10th, 1962), held that under applicable local law (Kansas) the authorized invasion of principal for the "happiness" of the income beneficiaries "established an ascertainable, external and judicially enforceable standard and that the trustees, in exercising such power, were limited by such standard and the supervision and control of the courts of Kansas in the exercise of their equity powers."

B. The Federal Cases Cited by Appellee in Support of Its Position That No Ascertainable Standard Has Been Created by the Instant Trust Are Readily Distinguishable on Their Facts.

The United States Supreme Court decisions in *Merchants Bank v. Commissioner,* 320 U.S. 256 (1943) and *Henslee v. Union Planters Bank,* 335 U.S. 595 (1949) have been discussed at some length in our Opening Brief at pages 16-20. Appellee, in its peremptory discussion of these cases at pages 20-21 merely reiterates their holdings that the powers of invasion involved precluded deduction of the charitable remainder notwithstanding the unlikelihood of the exercise of the invasionary power.

Appellee does not comment upon the contentions made in our Opening Brief to the effect that the Supreme Court in *Merchants* relied upon the subjective nature of the standard, the direction to the trustee to be liberal in exercising the power of invasion, and the direction to the trustee to consider the interest of the life beneficiary prior to the claims of the residuary beneficiaries. Similarly in *Henslee* the income of the trust was to be used as the life beneficiary saw fit, while the trustees were directed to invade the corpus to expend an additional amount for the "pleasure, comfort and welfare" of the life beneficiary, again a subjective standard. The trustees were further instructed that the "first object to be accomplished . . . is to take care of and provide for my mother in such manner as she may desire . . ." and the charitable interest "is a residuary bequest . . . and is not to infringe on any of the other legacies hereinbefore provided." The above factors were determinative in each decision. None of them are present in the instant case.

The case of *Commissioner v. Sternberger's Estate*, 348 U.S. 187 (1955), is not in point as it involved a deduction of the actuarially computed value of a charitable bequest which was to take effect only if decedent's childless daughter died without descendants surviving her and the decedent. Section 81.46 of Treasury Regulations 105 stated that if the legatee was empowered to divert the fund to a use which would have rendered it not deductible, the charitable deduction will be limited to that portion of the fund exempt from the exercise of the power. The court's statement, quoted by appellee at page 13 of its Brief, to the effect that where the principal of a bequest to charity may be invaded for private purposes, only the amount that is *assured* the charity is deductible is limited to transfers subject to a condition under present Treasury Regulations §20.2055-2(b). The Regulations and judicial decisions governing the instant case are in no way so restrictive. Any power of invasion by the trustee would mean that no amount would be *"assured"* the charity. A charitable deduction is proper where, as stated in *Ithaca Trust Co. v. United States*, 279 U.S. 151, 154 (1929): "There was no uncertainty appreciably greater than the general uncertainty that attends human affairs."

The cases that follow are considered in the sequence which they appear in appellee's Brief:

In *Newton Trust Co. v. Commissioner*, 160 F. 2d 175 (C.A. 1st, 1947), the trustee was given a power "to make such payment or payments to or for the use and benefit of my said wife as it may in its sole discretion deem advisable." The court found that "use and benefit" connote considerably more than the maintenance

of a standard of living and that the term "benefit" means "whatever promotes welfare, advantage, profit." Massachusetts law did not support the taxpayer's position.

Merrill Trust Co. v. U.S., 167 F. Supp. 474 (D.C. Me., 1958), involved an invasion of principal when either life beneficiary determined that more than net income was necessary for her support. The judgment of the life beneficaries was stated by the trustor to be conclusive in this respect. The court held at page 480 that Maine law did not require that the trustee determine that the beneficiary was acting in good faith before complying with a request for payment of principal. Thus no fixed standard was present.

The court in *Gammons v. Hassett,* 121 F. 2d 229, 232 (C.A. 1st, 1941), looked to Massachusetts law to determine whether, a direction by the trustor to pay to decedent's wife the income and "so much of the principal thereof as my said wife may at any time and from time to time need or desire" would permit a deduction. The word "desire" was determinative in that local law did not limit the power of invasion to the maintenance of the wife's standard of living. The power of invasion based on the subjective whim of the life beneficiary was fatal to the taxpayer.

The recent case of *Zentmayer's Estate v. Commissioner,* 336 F. 2d 488 (C.A. 3d, 1964), involved a power of invasion for any purpose which the "trustees shall deem expedient, necessary or desirable for the *benefit* or use of . . . [the life beneficiary.]" (Emphasis added.) The court, at page 490, held that the trustees, under Pennsylvania law, *must* invade principal to the extent necessary to maintain the life beneficiary's

standard of living, and they *may* take additional funds from the principal if, in their judgment, the expenditures would be for her benefit or use. "Benefit" was defined by the Supreme Court of Pennsylvania as "anything that works to the advantage or gain of the recipient." A strong dissent in *Zentmayer* pointed out that Pennsylvania law allows the court to put itself in the position of the testator and that under the facts it is inconceivable that he intended the words in his will to mean anything more than that principal could be used only to assure that the life beneficiary, who was 80 years old and a "homebody," could continue in her prior mode of living.

De Castro's Estate v. Commissioner, 155 F. 2d 254, 256 (C. A. 2d, 1946), as pointed out by appellee, found the standard too vague where corpus could be invaded "if during the life of my wife . . . due to her illness, accident or other *unforeseen emergency,* the income of the two (2) trusts shall not be sufficient to *amply* provide for her needs. I especially direct that no one shall have the right to call in question the propriety or the amount so applied for my wife." The court adopted the Tax Court's opinion which stated:

> "While the conditions under which the corpus of the trusts here might be invaded, that is, in the event of 'illness, accident or other unforeseen emergency,' were somewhat more restricted than the Merchants National Bank of Boston case, still we can not say that they were, or are, so highly improbable of occurrence as to leave no uncertainty as to the vesting of or the amount of the charitable bequests. And once the way to the invasion is open it is entirely in the discretion of the trustee as to what amounts 'will amply provide for her (the wife's) needs.'"

The *De Castro* case obviously turned on the question of whether the likelihood of invasion was so remote as to be negligible. The Tax Court was influenced by the use of the word "amply" which was equivalent to a direction to be "liberal."

In *State Street Bank & Trust Co. v. U. S.,* 207 F. Supp. 955 (D.C., Mass., 1962), the District Court found for the government, on the ground that "requirement," where invasion was authorized for the life beneficiary's "comfortable support and maintenance and for any other reasonable requirement," actually meant "demand" under Massachusetts law and that "demand" was too subjective a standard. The Court of Appeals in a brief opinion (313 F. 2d 29) affirmed the District Court.

The Tax Court in *James v. Commissioner,* 40 T.C. 494 (1963) found for the government where the will, as appellee herein stated (Govt. Br. p. 23), used language ("or for any reason whatsoever") strikingly similar to the language in the instant case which the government wishes this court to limit its consideration. However, in *James* there was no intent expressed to limit invasion to remedy a need or want. The trustee therein was authorized to invade "*either for* comfortable maintenance and support, for educational requirements, illness, operations, or for any reason whatsoever which shall to my trustees, in their sole discretion seem sufficient." (Emphasis added). Apparently there was no consideration given to the question of how said language would be interpreted by local law.

Marine Trust Co. of Western New York v. U. S., 247 F. Supp. 278, 280 (W.D. N.Y., 1965), is the last case cited by appellee in attempting to compare the

trust language of the instant cases to prior federal decisions involving a charitable deduction. Appellee neglected to present the facts of the case. There the trustor specifically directed the trustee to pay the net income and "so much of the principal as may be necessary to maintain . . . [the life beneficiary] in the same standard of living which she shall have enjoyed." In a separate subsection the trustor *additionally* directed that "if by reason of sickness, accident or any other circumstances" his daughters were "in need of funds for health, support, maintenance, comfort, welfare or for any other reason" the trustee may also invade principal. In this regard a written request from either daughter for such payments was to be sufficient authority for the trustee to make such payments. The court found no ambiguity in wording or doubt as to the intention of the trustor.

None of the foregoing authorities relied upon by appellee is sufficiently similar to the instant case to support the government's position. We repeat for the benefit of the court Section Six, the provision authorizing invasion of the corpus, in the Erb Trust:

> "If at any time or times during the life of this trust, the Trustor—and after his death, the said EMMA ERB, if she shall survive him—shall be in want of additional moneys for reasonable support, care and comfort, or for expenses of accident, illness or other misfortune, or for any purpose whatsoever, whether included in the foregoing classification or not; in such case of want or need, it shall be the duty of the Trustee, in its sole un-

controlled discretion, to pay to or to use or to apply or to expend for the said Trustor or EMMA ERB, his said wife, as the case may be, such portion or portions of the corpus of this trust estate, up to and including the whole thereof, as the Trustee may deem necessary to meet such want."

The following factors in the instant case are significant in relation to the reasoning of the foregoing federal decisions:

1. The power of invasion by the trustee is in no way related to or to be measured by the subjective desires or wishes of the beneficiary;

2. There is no provision in the trust directing the trustee to be liberal in exercising his power of invasion on behalf of the life beneficiary;

3. There is no direction to the trustee that the trustor's first object was to provide for the life beneficiary or that consideration of the interests of the life beneficiary are paramount to the residuary beneficiaries;

4. The plain meaning of Section Six itself compels the conclusion that the trustor directed his trustee to invade the corpus to maintain Emma's accustomed standard of living if the need should arise. The trustor first set out circumstances in which the power of invasion shall be exercised—"*If* . . . Emma Erb . . . shall be in *want* of *additional* moneys for *reasonable* support, care and comfort, or for expenses of accident, illness or other misfortune, or for any purpose what-

soever, whether included in the foregoing classification or not." He then said ". . . *in such case of want or need*, it shall be the *duty* of the Trustee" to invade the corpus "as the Trustee *may deem necessary to meet such want*." The entire provision is drafted in terms of "want or need." It is totally illogical to limit the discretion of the trustee in invading the corpus to situations where the life beneficiary is in "*want* of *additional* moneys" or to preface the words "support, care and comfort" by the word "*reasonable*," or to set out classifications which have characteristics of *emergency* ("accident, illness or other misfortune"), or to impose a "*duty*" on the trustee "to meet such *want*," if the trustor had any intention of allowing the trustee to invade the corpus "for any purpose whatsoever . . . in its sole uncontrolled discretion" as the appellee suggests.

Appellee has taken the position that the last quoted language of the trust, considered by itself, is conclusive in this case. However, the test is "whether by *the terms* of the trust . . . the trustee's or beneficiary's power of invasion is limited by definite and ascertainable fixed standards." 4 Mertens, Law of Federal Gift and Estate Taxation (1959), 397. (Govt. Br. p. 15.) No authority suggests, as does the government in this case, that the question before this court should be controlled by only the specific provision granting the power of invasion, let alone certain portions thereof. Ostensibly, the appellee admits that the decedent's intent should be determined from the *four corners* of

the trust instrument. (Govt. Br. p. 26.) However, repeatedly appellee would have this court, as did the lower court, look only to the phrase "for any purpose whatsoever" without considering that this language is to be read in the context of the entire power of invasion provision which in turn must be interpreted in the light of other provisions (or lack thereof) in the trust. See Appellee's Brief, page 2: "Questions Presented"—"directions to the trustee . . . to use any part of the corpus 'for expense of accident, illness or other misfortune, or for any purpose whatsoever' "; page 7, "That provision, which is the basis of the present law suit . . ."; page 9, "Summary of Argument"—"invade the charitable remainders . . . 'for any purpose whatsoever' "; page 10, "The pertinent provision of the trust is Section Six . . ."; page 17, "The issue in the present case is thus narrowed to the question of whether the terms of Section Six . . ."; page 18, "The critical language of Section Six is . . ."; page 21, "The invasionary power which the decedent here granted to the trustee ('for any purpose whatsoever') . . ." Appellee further misleads the court in stating "the purposes for which the widow could and might *wish* to have the funds spent did not lend themselves to reliable prediction" (Govt. Br. p. 12) and "decedent wanted the trustee to invade corpus if necessary to satisfy any reasonable *desire* his widow might have." (Govt. Br. p. 30.) Nowhere in the trust instrument is the trustee directed or permitted to take into consideration Emma's subjective wishes or desires.

C. Although an Ascertainable Standard Should Be Discernible From the Plain Meaning of the Trust if Compared to Prior Federal Decisions, Interpretation of the Trust Under State Law Compels the Conclusion That the Trustee Is Limited in Its Power of Invasion to the Maintenance of the Standard of Living Which the Life Beneficiary Had Enjoyed at the Time of Decedent's Death.

In the closing pages of its Brief (pp. 25-30), appellee gives cursory consideration to the effect of California law on the interpretation and administration of the Erb Trust. Three points are urged. Appellee asserts that nothing can be read into a trust instrument not already there (p. 26), that the words "sole uncontrolled discretion" as applied to the invasion of the corpus result in a waiver by the trustor of the California requirement that the trustee must exercise reasonable judgment (p. 27), and that the trustee could invade the corpus for Emma's benefit without consideration of her other resources. (Pp. 27-29.) None of these three assertions is well founded.

There is no question that the general rule in California is that a trustor's intent is to be determined from the four corners of the trust instrument. (Govt. Br. p. 26.) The same rule is equally applicable to contracts and wills. Calif. Code of Civ. Proc. §1856. Of course, there are various exceptions to the rule that in interpreting a writing no evidence is allowed other than its contents. See Witkin, California Evidence, pp. 397-421. In ascertaining the meaning of an instrument wherein there is a patent ambiguity, parol evidence is admissible to interpret it. *Witkin, supra*, 413.

The parol evidence rule is no less applicable to trusts than to contracts or wills. In California, the courts

"in seeking the true construction of a trust instrument, *inter vivos* or testamentary as the case may be . . . must *if possible* ascertain and effectuate the intention of the trustor as expressed by the language of the instrument itself." (Emphasis added).) *Lombardi v. Blois*, 230 Cal. App. 2d 191, 197. Appellee misstates the rule in contending that "California courts would determine the decedent's intent from the four corners of the trust instrument *alone*." (Govt. Br. p. 26.) (Emphasis added.) The trust instrument is the primary, not the only, consideration in determining the nature, extent and object of a trust.

As stated in 2 Scott on Trusts (2d ed.) at page 828:

> "In determining the terms of the trust, resort is had in the first place to the instrument, if any, under which the trust is created. As to any matter expressly covered by the instrument, the provisions of the instrument, if unambiguous, determine the terms of the trust. In such a case, extrinsic evidence in the absence of fraud or mistake, is not admissible to vary or add to the terms of the instrument. Where the instrument contains no express provision or where a provision is ambiguous or uncertain in its meaning, resort may be had to extrinsic evidence to determine the terms of the trust."

Although the plain meaning of the Erb Trust limits the trustee's power of invasion to the maintenance of Emma's standard of living, the trial court's decision indicates that Section Six, which grants the power of invasion, if read as appellee and the trial court read it, is ambiguous in that such interpretation of the lan-

guage "or for any purpose whatsoever" is entirely inconsistent with the structure of the paragraph creating the power of invasion and the trust as a whole. In ascertaining the intention of the trustor, the court is not limited to determining what is meant by any particular phrase, but should consider the necessary implications arising from the language of the instrument as a whole. *Brock v. Hall,* 33 Cal. 2d 885, 889. This means that the language in a particular trust declaration is to be interpreted, not as an isolated statement of intention, but in the light of the entire declaration. *Randall v. Bank of America,* 48 Cal. App. 2d 249, 252. The lower court's construction of the scope of the power of invasion should be rejected as it is entirely inconsistent with the apparent purposes of the instrument taken as a whole and might well defeat one of the beneficent purposes of the trust, Ludwig's intention to benefit the charities. The meaning of particular words, phrases, and provisions is subordinate to the scheme, plan, or dominant purpose of the trustor. *Estate of Raymond,* 96 Cal. App. 2d 808.

If Section Six is ambiguous, then evidence of the circumstances surounding the execution of the trust agreement is admissible to explain any uncertainty appearing upon the face of the instrument. There is no evidence or implication that the paramount object of Ludwig's bounty was his surviving spouse. The trust must be read in the setting in which the trustor has cast it in order to ascertain his individual intention. "Intention" is significant in determining whether an ascertainable standard exists in that the trustee is bound by the trustor's intent. We will not repeat the circumstances surrounding the execution of the Erb Trust

or those that existed at the date of Ludwig's death, except to mention that Emma's income from her own estate and the anticipated income from the trust was far more than she needed for any reasonable purpose. It is clear that Ludwig created the power to invade the principal as a safeguard in the event Emma should be in need or want of additional funds due to any emergency; in short, the trustee was to invade corpus, if necessary, to maintain Emma in her accustomed standard of living.

Appellee also argues that the words "sole uncontrolled discretion" result in a waiver by the trustor of the requirement that the trustee exercise a "reasonable judgment" in invading the corpus. *Coberly v. Superior Court,* 231 Cal. App. 2d 685, is used to support this contention. It should be noted, however, that the quotation from *Coberly* set out by appellee (p. 27) is not supported by California authorities but taken *in part* from Restatement of Trusts, Second, Section 187(j). Appellee neglected to add the following language of Section 187(j):

> "In such a case the mere fact that the trustee has acted beyond the bounds of a reasonable judgment is not a sufficient ground for interposition by the court, *so long as the trustee acts in a state of mind in which it was contemplated by the settlor that he would act.* But the court will interfere if the trustee acts in a state of mind not contemplated by the settlor. Thus, the trustee will not be permitted to act dishonestly, or from some motive other than the accomplishment of the purposes of the trust or ordinarily to act arbitrarily without an exercise of his judgment." (Emphasis added.)

The *Coberly* case involved a petition for writ of mandate to set aside an order of the Superior Court sitting in probate, which struck objections to the first account of a testamentary trustee. The theory of the testamentary trustee in the lower court was that the beneficiary was not entitled to complain of neglect of duty in the administration of the trust, because the terms of the will creating the trust gave the trustee absolute discretion in the management of its assets. The appellate court disagreed with this theory stating at page 689:

> "The exercise of judgment by a professional trustee, even if not required to satisfy the standard of a reasonable prudent man, is the very purpose for which the trustee was employed, and exculpatory powers in the trust instrument are strictly construed. It ill behooves a professional trustee, holding itself out during the solicitation of business as a respository of special competence and expertise, to claim on an accounting it need not answer the charge of neglect of duty. A banker, a doctor, a lawyer, may not gain business as a specialist and defend mistakes as a layman. (Estate of Ferrall, 41 Cal. 2d 166, 174 [258 P. 2d 1009]; Bogert, Trust & Trustees (2d ed.) §542.)"
>
> "We believe that a grant of absolute discretion in the management of a trust still requires a professional trustee to affirmatively exercise its judgment in handling the trust assets. . . ."

In the instant case, the trustee was not given absolute discretion in the management of the trust nor

even as to whether to invade the corpus to satisfy the needs of Emma. Ludwig directed that "it shall be the *duty* of the trustee . . . to expend . . . such portions of the corpus . . . as the trustee may deem necessary to meet such want." It would seem that where the trustee is under a *duty* to act, the concept of "sole uncontrolled discretion" is completely inconsistent with that *duty*. This type of discretion is normally given to a trustee, as it was here, in determining the amount of corpus to be distributed in order that the trustee should not have to justify to the penny the amount of each and every distribution. There is no reasonable basis for concluding that Ludwig waived the exercise of the trustee's reasonable judgment in invading the corpus where necessary to permit Emma to live in her accustomed manner.

Additionally, contrary to appellee's contentions (Govt. Br. pp. 27-29), the trustee could not invade the corpus without looking to Emma's other resources. Appellee cites no authority in support of its contention other than *Estate of Ferrall,* 41 Cal. 2d 166, which held that the trustee should consider a beneficiary's other means in exercising his discretion to disburse the principal unless the language of the trust *affirmatively* reveals an intention to make a gift regardless of the beneficiary's other means. No such *affirmative* statement of intent is present in the Erb Trust.

Appellee in its Brief states (p. 28) that "the trust instrument affirmatively reveals an intention to benefit Mrs. Erb without regard to her personal resources."

Appellant is somewhat at a loss as to whether the government is actually trying to mislead this court or whether the statement is merely irresponsible, but a reading of the original trust instrument and the amendments thereto reveals no intention, either affirmatively or by implication, to benefit Emma without regard to her personal resources. On the contrary, the language of Section Six indicates that the trustee is to invade the corpus only after considering Emma's ability to meet her needs from her own assets and from other sources of income.

The trustor imposes a duty on the trustee to invade the principal on Emma's behalf if she "shall be in *want* of *additional* moneys" for certain purposes. The word "additional" certainly imposes a duty upon the trustee to consider whether there would be a "want of *additional* moneys" and, of course, the question to be answered would be "in addition to what?". The only logical answer wonld be "in addition to the truat income, her own assets and other sources of income."

Appellee states that appellant must overcome the rule of the Restatement of Trusts, Second, Section 128, Comment (e), that there is an inference that a beneficiary is entitled to support out of the trust fund even though he has other resources. The Restatement simply declares that the right to invade under such circumstances is a question of interpretation. Additionally, no California case can be found that cites the Restatement rule that an inference exists. It must be concluded that the California courts, in view of *Ferrall*, would restrict the trustee's power of invasion until Emma was "in want of additional moneys" for the specified purposes, after taking into consideration her other resources.

II.

A Reading of the Interpretative Regulations of the Treasury Department Discloses That the Regulations Themselves Are Inconsistent With Appellee's Position.

Appellee, although accepting our statement of facts and expressly conceding that there was no probability, as of the date of Ludwig's death, of invasion of corpus, made an important omission on its Brief in setting forth the applicable statute and Regulations.

In our Opening Brief (pp. 14-15), we invited the Court's attention to Treasury Regulations §20.2055-2 and quoted the pertinent language thereof. Appellee in its Brief (p. 5) refers to said Regulation but indicates that only section (a) thereof is material to this case. Said section (a), entitled "Remainders and Similar Interests," is directed at the typical life estate in favor of a private party with remainder over to a tax-exempt charity. If there were no power of invasion in the Erb trust, section (a) alone would be the controlling Regulation. However, the existence of Section Six of the trust, authorizing invasion of the corpus, requires reference to section (b) of said Regulation which is entitled "transfers Subject to a Condition or a Power."

That the omission by appellee of any reference to section (b) is not inadvertent becomes apparent from an examination of its language.

The court will note that section (a) makes a charitable remainder deductible ". . . only insofar as that interest is *presently ascertainable* . . . ." Where, as here, there is a power to invade, the extent to which the remainder is "presently ascertainable" cannot be deter-

mined without reference to section (b) which purports to be interpretative of the statute under such circumstances.

Said section reads as follows:

> "(b) *Transfers subject to a Condition or a Power.* If, as of the date of a decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is *so remote as to be negligible.* If an estate or interest has passed to or is vested in charity at the time of a decedent's death and the estate or interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been *highly improbable* at the time of the decedent's death, the deduction is allowable." (Emphasis added.)

It is apparent that the Regulation drafted by the very governmental agency which seeks to deprive the charitable remaindermen of their tax-exempt status as beneficiaries under the Erb Trust is inconsistent with appellee's argument. Thus, appellee argues a position contrary to that expressed by a Regulation it consistently contends has the force of law. (*Helvering v. Winmill,* 305 U.S. 79.)

Paraphrasing section (b), ". . . as of the date of (Ludwig's) death (the) transfer(s) for charitable purposes (were) dependent upon the performance of

some act or the happening of a precedent event (invasion or noninvasion of the corpus) in order that (they) might become effective." Obviously, if the trustee distributed the entire corpus to Emma there would be no estate left to pass to the charities.

Section (b) goes on to state that under such circumstances no deduction is allowable unless ". . . the possibility that the charitable remainder will not become effective is so remote as to be negligible." Again, the Regulation states that if the charitable interest ". . . would be defeated by the performance of some act . . ." (*i.e.*, the invasion of the corpus), "the deduction is allowable if the occurrence of the act . . ." appears to be highly improbable at the time of decedent's death.

It is thus apparent that the Regulations themselves contemplate that, under the fact situation herein presented, whether the charitable remainder interest is presently ascertainable requires a determination as to whether the likelihood of invasion is "so remote as to be negligible" or is "highly improbable." Since it is conceded that the likelihood of invasion was "very small" and since the undisputed facts as to Emma's "age, private income and modest personal living habits" (Govt. Br. pp. 17-18) make it plain that invasion was "highly improbable" and "so remote (a possibility) as to be negligible," the government's position is not tenable.

Further, the improbability of invasion in the light of the circumstances at the time of Ludwig's death is inescapably confirmed by the fact that there was no

invasion up to the time of Emma's death, at which time the power terminated.

This latter compelling evidence may be properly considered probative of the unlikelihood of invasion at the time of Ludwig's death, rather than as conclusive evidence of the actual fact.

In *Lincoln Rochester Trust Company v. McGowan,* 217 F. 2d 287 (C.A. 2d, 1954), Judge Medina, after discussing *Henslee v. Union Planters Nat. Bank,* 335 U.S. 595, and earlier decisions, stated at page 293:

> "None of these authorities, however, sustain the broad proposition that evidence of events occurring after testator's death is never admissible. But they do impel the conclusion that, unless specifically provided for by statute, actual events occurring after the testator's death may never be substituted for the estimate of probable events made as of the time of the testator's death and based upon circumstances as they existed on that date. It seems quite clear, therefore, that only those events occurring after the testator's death which have sufficiently high probative value in establishing or clarifying the circumstances as they existed at the time of testator's death may properly be considered in making the factual determination as to the probability and extent of the exercise of a right to invade."

This court, in *Commissioner v. Wells Fargo Bank,* 145 F. 2d 130, at page 131, citing its earlier decision (133 F. 2d 753) stated:

> "This court in the Bank of America case, supra, relied on the Ithaca Trust Co. case, supra. We

refused to follow the rule propounded herein by the Commissioner, that the mere existence of the legal power to invade the corpus of a trust in favor of a private individual defeats the charitable gift deduction, but rather *looked to the actualities of the situation*, found sufficient certainty of the value of the charitable bequest in the improbability of an invasion of corpus, and concluded that the deduction was allowable." (Emphasis added.)

See also: *Commissioner v. Robertson's Estate*, 141 F. 2d 855 (C. A. 4th, 1944); *Bowers v. South Carolina Natl. Bk.*, 228 F. 2d 4 (C. A. 4th, 1955).

In this court's earlier *Bank of America* decision the opinion included the following appropriate comment:

"Naturally, cases arising under this statute present gradations of probability; and we do not wish to be understood as suggesting that charitable bequests in remainder are deductible where there is real likelihood of an undetermined part of the corpus being taken for the benefit of the life tenant. It is the duty of the Commissioner, in administering this statute, to give effect to the beneficent purpose of Congress, and we believe a proper performance of the duty requires that attention be paid to the *actualities of each case*. The administrative difficulties in the way of doing that are not insurmountable. On the other hand, a blind adherence to arbitrary standards must result in many instances in the needless frustration of the legislative policy." (Emphasis added.)

Conclusion.

The plain meaning of the trust sets out a presently fixed and ascertainable standard regarding the invasion of the corpus, to wit, the maintenance of Emma's standard of living out of the corpus if additional moneys are required in "case of want or need." Any interpretation under California law of the terms of the trust necessitates this conclusion.

It is regrettable that appellee in its overzealous desire to impose a tax on the interests of the six charitable remaindermen should attempt to read into the invasion clause a carte blanche power which was never intended. Although it denies such an effort (Govt. Br. pp. 26-27), its succeeding remarks ". . . even the 'reasonable judgment' standard has been waived by the trustor" belie this statement.

The phrase ". . . or any other purpose whatsoever" is not the all-encompassing language appellee paints it to be. As stated in *Estate of Wood*, 39 T.C. 919:

> "Admittedly, the words 'support', and 'maintenance' are regarded as referable to a standard of living, and the addition of the naked words 'comfort' and 'welfare' in the context of the instrument before us merely rounds out the standard of living concept."

The dissenting opinion in *Zentmayer's Estate v. C.I.R.*, 336 F. 2d 488, 492-3 (C.A. 3d, 1964) contained the appropriate language which follows:

> ". . . it can only be said that the scrivener of the will, in the mooted phrase, merely 'painted the lily' of the testamentary design."

The appellee in its Brief has not answered appellant's arguments, but has deliberately attempted to restrict the court's consideration to a limited portion of the trust rather than to its context and to the trustor's obvious intent. The tax cases cited by appellee as authority for its position are not determinative in that they are readily distinguishable. Further, none of the cases concerns a California trust.

It should be concluded that the trust, construed as a matter of law, discloses an intention to provide for a continuance of the mode of life and standard of living of the life beneficiary and that consequently, there is a sufficiently definite and fixed standard to permit ascertainment with reasonable certainty of the value, as of the date of death of the decedent, of the bequest to charitable remaindermen.

For the reasons stated in Appellant's Opening Brief and found herein, the judgment of the District Court should be reversed.

Respectfully submitted,

BODKIN, BRESLIN & LUDDY,
HENRY G. BODKIN, JR.,
HARRY A. OLIVAR,
Attorneys for Appellant.

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

HENRY G. BODKIN, JR.

No. 20,844

IN THE

United States Court of Appeals
For the Ninth Circuit

ARRELL ZWANG and ELODYMAE ZWANG, *Appellants,*	
vs.	
TEWART L. UDALL, as Secretary of the Interior of the United States of America, *Appellee.*	

On Appeal from the United States District Court for the Southern District of California, Central Division
Honorable E. Avery Crary, Judge

BRIEF FOR APPELLANT

RAME & COURTNEY,
330 North Fifth Street,
P. O. Box 895,
Coalinga, California,
Attorneys for Appellants.

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Subject Index

	Page
urisdictional statement	1
tatement of the case	2
tatutes and regulations involved	4
pecification of errors relied on	7
uestions presented	8
ummary of argument	8
rgument	9
I. The April 3, 1963, action by the Land Office was not lawful action	9
A. The April 3, 1963, action was not authorized by the regulations of the Department of the Interior	9
B. "Contest and Protest" as used in 43 C.F.R., Subpart 1852, are the same as "contest or protest" used in 43 U.S.C. §1165 and 43 C.F.R. 1862.6	11
C. The April 3, 1963, action by the Riverside Land Office deprived appellants of due process of law	12
II. There was no "contest or protest" pending when appellants filed their complaint in the District Court	15
III. The District Court had jurisdiction to grant plaintiffs' request and should have done so	17
IV. Exhaustion of administrative remedies is not required; and if required, plaintiffs have done so	22
nclusion	24

Table of Authorities Cited

Cases

Pages

Best v. Humboldt Placer Mining Co., 371 U.S. 334, 83 S. Ct. 379, 9 L. Ed. 2d 350 (1963) 14

Everett v. Wallin, 184 N.W. 958 (1921) 16

Greene v. United States, 376 U.S. 149, 84 S. Ct. 615, 11 L. Ed. 2d 576 (1964) 23

Lane v. Hoglund, 244 U.S. 174, 37 S. Ct. 558, 61 L. Ed. 1066 (1917) 17, 22

McCord v. Granger, 201 F. 2d 103 (C.A. 3, 1952) 11

Miller v. Commissioner, 333 F. 2d 400 (C.A. 8, 1964) 11

Morgan v. U. S., 304 U.S. 1, 58 S. Ct. 773 14

Pan American Petroleum Corp. v. Pierson, 181 F. Supp. 557 (D.C. Wyo., 1960) 11

Pan American World Airways v. Boyd, 207 F. Supp. 152 (D. of C., 1962) 23

Payne v. Newton, 255 U.S. 438, 41 S. Ct. 368, 65 L. Ed. 720 (1920) 17, 2

Sheridan Wyoming Coal Co. v. Krug, 172 F. 2d 282 (C.A. D.C., 1949) 10, 1

S.S.W. v. Air Transport Assn., 91 F. Supp. 269 (D. of C., 1950) 2

Stewart v. Penny, 238 F. Supp. 821 (D. Nev., 1965) 2

Stockley v. U. S., 260 U.S. 532, 67 L. Ed. 390 (1923) 1

Udall v. Wisconsin, Colorado and Minnesota, 306 F. 2d 790 (C.A. D.C., 1962) 20, 2

United States ex rel. Champion Lumber Co. v. Fisher, 227 U.S. 445, 33 S. Ct. 329, 57 L. Ed. 591 (1912) 1

Statutes

Judicial Code of 1911, Section 250 1

28 U.S.C. Section 1291 ....

28 U.S.C. Section 1361 ....

Pages
3 U.S.C. Section 321, et seq. (Desert Land Entry Act) ... 1
3 U.S.C. Section 1165 ....2, 4, 7, 8, 11, 12, 16, 17, 18, 19, 22
4 U.S.C. Section 305(a) 11

Regulations

3 Code of Federal Regulations:
Section 1852 8
Section 1852.1 .... 9, 12
Section 1852.1-1 ....9, 10, 12
Section 1852.1-2 ....10, 12
Sections 1852.1-3 to 1852.1-8 .... 9, 10
Section 1852.2 ....10, 11, 12
Section 1852.2-1 10
Section 1852.2-2 ....3, 5, 10
Section 1862.6 ....6, 11, 12, 22

Texts

) Am. Jur., Section 348, pp. 343-345 12
) Am. Jur., Section 363, pp. 367-369 12
Davis, Administrative Law, p. 426 14
ublic Land Review: Hearings on S. 758, 88th Congress (U.S. Govt. Printing Office, 1963), pp. 177-179 12

No. 20,844

IN THE

United States Court of Appeals

For the Ninth Circuit

Darrell Zwang and Elodymae Zwang,
Appellants,
vs.
Stewart L. Udall, as Secretary of the Interior of the United States of America,
Appellee.

On Appeal from the United States District Court for the Southern District of California, Central Division
Honorable E. Avery Crary, Judge

BRIEF FOR APPELLANT

JURISDICTIONAL STATEMENT

This is an appeal from a judgment entered on Feb-uary 23, 1966, by the United States District Court for he Southern District of California, Central Division, lismissing appellant's complaint. The underlying acion is one in the nature of mandamus to compel the Secretary of the Interior to issue patents to appelants, as entrymen under the Desert Land Entry Act. (43 U.S.C. § 321, et seq.) Jurisdiction of the District Court was invoked under 28 U.S.C. § 1361. Appellants

filed a timely notice of appeal following the entry of the judgment of the District Court. (R. 59.) This Court's jurisdiction rests upon 28 U.S.C. §1291.

STATEMENT OF THE CASE

Appellants seek patents for two desert land entries in Riverside County, California. Appellants rely on the provisions of 43 U.S.C. § 1165. They contend that after the lapse of two years from the date of issuance of receipts upon filing final proofs, there was no "pending contest or protest" against their entries, and therefore they are entitled to patents.

The facts were stipulated to at the Pre-Trial Conference and are as set forth in the Pre-Trial Order (R. 20):

A. Desert land entries comprising 320 acres each in the N½ and the S½ Sec. 19, T. 4S., R. 16 E., S.B.M., an oversize section in Riverside County, California, were allowed January 6, 1955, and subsequently assigned to appellants, the Zwangs, who are husband and wife.

B. Final proofs were submitted on May 17, 1961. The register's receipt is dated May 29, 1961.

C. By decision dated May 8, 1962, the Land Office at Riverside rejected the final proofs. (Exh. A.)

D. The Zwangs appealed to the Director, Bureau of Land Management.

E. On October 10, 1962, the Division of Appeals, Office of the Director, reversed the decision of the Land Office and remanded the cases to the Land Office for further consideration. (Exh. B.)

F. On April 3, 1963, the Land Office accepted the final proofs for 80 acres in each entry and cancelled the entries as to the remaining lands. (Exh. C.)

G. The decision of April 3, 1963, was made by the Land Office *ex parte,* without a hearing and without prior notice to the Zwangs. A hearing was not waived by the Zwangs. The decision of April 3, 1963, was made by the Land Office based upon the records and documents contained in its files.

H. The Zwangs appealed again to the Director, Bureau of Land Management, and requested a hearing. On October 23, 1963, the Division of Appeals, Office of the Director, denied the Zwangs' request for a hearing and modified and affirmed the decision of the Land Office. (Exh. D.)

I. The Zwangs then appealed to the Secretary of the Interior, who issued his decision on February 3, 1965. (Exh. E.)

J. At the time the Zwangs filed their complaint herein, no contest within the framework of 43 C.F.R. 1852.2-2, had been filed. None has been filed since.

K. The Zwangs have not received patents for their entries.

L. The Zwangs' request for patents covering 320 acres on each entry was denied by the Land Office on March 5, 1965. (Exh. G.)

M. Appellee Stewart L. Udall is the Secretary of the Interior.

The February 3, 1965, decision (Exh. E) "set aside" the earlier decisions and remanded the case "for the initiation and prosecution of a contest".

There were no facts to be litigated at trial, and the only issues involved were and are questions of law.

The District Court entered judgment dismissing appellants' complaint (R. 57), having concluded that it was "without jurisdiction to determine whether the action of the Land Office on April 3, 1963, constituted a protest". (R. 53.)

This appeal followed.

STATUTES AND REGULATIONS INVOLVED

1. 43 U.S.C. § 1165 provides in pertinent part:

   "* * * That after the lapse of two years from the date of the issuance of the receipt of such officer as the Secretary of the Interior may designate upon the final entry of any tract of land under the homestead, timber-culture, desert-land, or preemption laws, or under the Act of March 3, 1891, and when there shall be no pending contest or protest against the validity of such entry, the en-

tryman shall be entitled to a patent conveying the land by him entered, and the same shall be issued to him; * * *."

2. 43 C.F.R. § 1852.2 provides in pertinent part:

"§ 1852.1 Private contests and protests.

"§ 1852.1-1 By whom private contest may be initiated.

Any person who claims title to or an interest in land adverse to any other person claiming title to or an interest in such land or who seeks to acquire a preference right pursuant to the act of May 14, 1880, as amended (43 U.S.C. 185), or the act of March 3, 1891 (43 U.S.C. 329), may initiate proceedings to have the claim invalidated for any reason not shown by the records of the Bureau of Land Management. Such a proceeding will constitute a private contest and will be governed by the regulations in the subpart.

"§ 1852.1-2 Protests.

Where the elements of a contest are not present, any objection raised by any person to any action proposed to be taken in any proceeding before the Bureau will be deemed to be a protest and such action thereon will be taken as is deemed to be appropriate in the circumstances."

3. 43 C.F.R. § 1852.2 provides in pertinent part:

"§ 1852.2 Government contests.

"§ 1852.2-1 How initiated.

The Government may initiate contests for any cause affecting the legality or validity of any entry or settlement or mining claim."

4. C.F.R. § 1862.6 provides:

"§ 1862.6 Patent to issue after 2 years from date of manager's final receipt.

"(a) The decision of the Supreme Court of the United States in *Thomas J. Stockley et al., appellants, v. the United States,* decided January 2, 1923 (260 U.S. 532, 67 L. ed. 390) holds that after the lapse of 2 years from the date of the issuance of the 'receiver's receipt' upon the final entry of any tract of land under the homestead, timber-culture, desert-land, or preemption laws, such entryman is, there being no pending contest or protest against the validity of such entry, entitled to patent under the proviso to section 7 of the act of March 3, 1891 (26 Stat. 1098; 43 U.S.C. 1165), regardless of whether or not the manager's final certificate has issued.

"(b) The Supreme Court of the United States in *Payne v. U. S. ex rel. Newton* (255 U.S. 438, 65 L. ed. 720), decided that Newton was entitled to a patent on his homestead entry under the proviso to section 7 of the act of March 3, 1891, 2 years having elapsed from the date of the issuance of the receiver's final receipt upon final entry, and there being no contest or protest pending against the validity of the entry, but stated that the purpose of the statute was:

"To require that the right to a patent which for 2 years has been evidenced by a receiver's receipt, and at the end of that period stands unchallenged, shall be recognized and given effect by the issue of the patent without further waiting or delay, and thus to transfer from the land officers to the regular judicial tribunals the authority to deal with any subsequent controversy over

the validity of the entry, as would be the case if the patent were issued in the absence of the statute."

SPECIFICATION OF ERRORS RELIED ON

1. The District Court erred in concluding that the jurisdiction to determine whether the action of the Land Office set forth in its decision of April 3, 1963, amounted to a protest within the meaning of Title 43 U.S.C. § 1165, has been exclusively delegated to the Secretary of the Interior.

2. The District Court erred in concluding that the Court is without jurisdiction to determine whether the action of the Land Office on April 3, 1963, constituted a protest.

3. The District Court erred in failing to conclude that the action of the Land Office on April 3, 1963, did not constitute a protest.

4. The District Court erred in failing to conclude that even if the action of the Land Office on April 3, 1963, constituted a protest, no contest or protest was pending at the time appellants filed this action.

5. The District Court erred in failing to conclude that it was not necessary for plaintiffs to have exhausted their administrative remedies prior to filing this action, or in the alternative, that appellants did exhaust their administrative remedies prior to the filing of this action.

6. The District Court erred in failing to conclude that appellants are entitled to patents for the whole of their Desert Land entries.

7. The District Court erred in entering judgment dismissing appellants' complaint.

QUESTIONS PRESENTED

1. Whether the Court has jurisdiction to review a determination by the Secretary of the Interior of whether a protest or contest has been instituted within the statutory period or of whether a contest or protest is pending at the expiration of the statutory period.

2. What are the circumstances under which such jurisdiction should be exercised?

3. Did the April 3, 1963, action of the Riverside Land Office (Exh. C) constitute a "protest" within the meaning of 43 U.S.C. § 1165, and if it did, was it "pending" at the time appellants filed their complaint in the district court?

4. Whether appellants were required to exhaust their administrative remedies before going into the District Court, and if so, whether appellants did so.

SUMMARY OF ARGUMENT

The terms "contest or protest" as used in 43 U.S.C. § 1165 do not mean action of any kind. They mean lawful action. The April 3, 1963, action by the Riverside Land Office (Exh. C) was not lawful action for two reasons. First, it was not authorized by the regulations of the Department of the Interior. Second,

due process of law required a hearing, and appellants were deprived of one. Even if the April 3, 1963, action was lawful action, it was no longer pending when appellants filed their complaint in the District Court. The refusal by the Secretary to issue patents to appellants is an arbitrary one and the Court has jurisdiction to compel the Secretary to do so. No exhaustion of administrative remedies is required because the issue involved is one of law and does not call for the exercise of administrative discretion. To the extent that exhaustion of remedies is required, appellants have met that requirement.

ARGUMENT

I. THE APRIL 3, 1963, ACTION BY THE LAND OFFICE WAS NOT LAWFUL ACTION.

A. The April 3, 1963, action was not authorized by the regulations of the Department of the Interior.

"Contest and Protest Proceedings" in the Department of Interior are governed by the provisions of 43 CFR, Subpart 1852.

It is important to note at the outset that the provisions of 43 CFR, Subpart 1852, are the provisions which were in effect (a) at the time appellants filed the final proofs for their desert land entries and (b) at the time appellants filed their complaint in the District Court.

Subpart 1852 has two divisions.

The first division, 1852.1, is entitled "Private Contests and Protests" and has grouped under it Sections 1852.1-1 through 1852.1-8.

Section 1852.1-1 states that "any person who claims title to or an interest in land adverse to any other person . . . may initiate proceedings" and "such a proceeding will constitute a private contest". Sections 1852.1-3 to 1852.1-8 require a complaint, an answer, and a notice of hearing, and provide for an adversary-type hearing before an impartial Hearing Examiner.

Section 1852.1-2 states that where the elements of a contest are not present, the objection raised will be considered a "protest" and "such action thereon will be taken as is deemed to be appropriate in the circumstances".

The second division, 1852.2, is entitled "Government Contests".

Section 1852.2-1 provides that "the Government may initiate contests for any cause affecting the legality or validity of any entry or settlement or mining claim". Sections 1852.2-2, et seq., require a complaint, an answer and a notice of hearing, and provide for an adversary-type hearing before an impartial Hearing Examiner.

There is no provision for a government "protest".

In summary, objections by private persons may be raised by contest or by protest. Objections by the government may be raised *only by contest.*

The regulations of the Department of the Interior bind both the Secretary and the entryman. As stated by the Court of Appeals for the District of Columbia in *Sheridan Wyoming Coal Co. v. Krug,* 172 F. 2d

282, 287 (C.A. D.C. 1949) construing a regulation of the Department of Interior regarding the leasing of federal coal lands:

> "The regulation was published in the Federal Register as one of general application and legal effect. It had the force and effect of statute. As such, it was binding upon the Secretary until repealed or modified by him."

See also 44 U.S.C., § 305 (a), and *Pan American Petroleum Corp. v. Pierson,* 181 F. Supp. 557, at 563 (D.C. Wyo. 1960. *Cf., Miller v. Commissioner,* 333 F. 2d 400 (C.A. 8 1964), and *McCord v. Granger,* 201 F. 2d 103 (C.A. 3 1952), dealing with regulations of the Treasury Department.

Appellee has never filed a contest against appellants' entries. The so-called "protest" action taken by him through the Riverside Land Office on April 3, 1963, neither was nor is authorized by the Department's regulations.

B. "Contest and Protest" as used in 43 C.F.R., Subpart 1852, are the same as "contest or protest" used in 43 U.S.C. §1165 and 43 C.F.R. 1862.6.

On page 4 of his Memorandum Opinion (R. 42) the district judge notes that a contest was not filed against appellants' entries. He also recognizes that 43 C.F.R. 1852.2 makes no provision for or reference to government protests. He apparently concludes, however, that as used in 43 U.S.C. § 1165 and its corresponding regulation, 43 C.F.R. 1862.6, supra, "protest" has a different meaning. The conclusion is not sound.

43 C.F.R. 1852.2 and 43 C.F.R. 1862.6 are upon the same subject matter: Management and disposal of the public lands. Both regulations are found in 43 C.F.R. —Public Lands: Interior; Chapter II—Bureau of Land Management; Subchapter A—General Management; and Group 1800—Public Administrative Procedures.

It is well-settled rule of construction that statutes upon the same subject matter must be construed together. (50 *Am. Jur.* § 348, pp. 343-345.)

It is equally well-settled that a statute must be read and construed as a whole in harmony with other statutes relating to the same subject matter. (50 *Am. Jur.* § 363, pp. 367-369.)

The question of what is meant by a "pending contest or protest" under 43 U.S.C. § 1165 and 43 C.F.R. 1862.6 is answered by 43 C.F.R. 1852.1 and 1852.2 The focal point is 43 C.F.R. 1852.1 and 1852.2 as they read at the time of filing of appellants' final proofs and now.

C. The April 3, 1963, action by the Riverside Land Office deprived appellants of due process of law.

A pertinent portion of a letter from the Department of the Interior, Office of the Secretary, to the Chairman, Subcommittee on Public Lands, Committee on Interior and Insular Affairs, U. S. Senate, dated July 5, 1963, found at pp. 177-179 in the report entitled "Public Land Review: Hearings on S. 758; Eighty-Eighth Congress" (U.S. Govt. Printing Office, 1963), states as follows (emphasis supplied):

"Preliminary to dismissing the question of the finality of examiner's decisions, it is helpful perhaps to set out the classes of land cases in which hearings before hearing examiners are held in accordance with the Administrative Procedure Act (5 U.S.C., 1958 ed., sec. 1001 et seq.). In addition to hearings on appeals in grazing cases, these cases involve contests, both private and Government, against mining claims and homesteads and desert land entries. In grazing cases the statutory hearing before an examiner ordinarily takes place on appeal after the initial adjudication by local officers of the Bureau of Land Management. *In contest cases, on the other hand, the hearing precedes the initial decision in the case.* However, in those grazing cases where there appear to be repeated or willful violations by a licensee or permittee, notice is served on the alleged violator and a hearing is held before a decision is made on the alleged violations.

"Viewing the question as limited to examiners' decisions in grazing cases, we are unable to perceive a logical distinction for drawing the line. If the suggestion is that examiners' decisions in all cases should be made final, a number of problems arise.

"*First, where 'due process' requires a hearing, and in our view that is true of the classes of cases we are here concerned with (United States v. O'Leary et al.,* 63 I.D. 341 (1956); *E. L. Cord dba El Jiggs Ranch,* 64 I.D. 232 (1957); see *Johnnie E. Whitted et al.,* 61 I.D. 172 (1953)), *the hearings must be and are held in accordance with the provisions of sections 7 and 8 of the Administrative Procedure Act.* So far as here ma-

> terial, these sections grant parties broad rights of administrative review. The procedure suggested by the question would eliminate those rights."

It has long been true that in administrative proceedings of a quasi-judicial character, the interests of a citizen must be protected by the rudimentary requirements of fair play. These demand a fair and open hearing. Failure to afford the opportunity for a hearing is more than a procedural irregularity. It is a vital defect.

> *Morgan v. U. S.*, 304 U.S. 1 at pp. 14 and 22, 58 S. Ct. 773, 776, 999, 1001.

The land department has no power to strike down any claim arbitrarily. "Due process in such case implies notice and a hearing".

> *Best v. Humboldt Placer Mining Co.*, 371 U.S. 334 at p. 337, 83 S. Ct. 379, 9 L. Ed. 2d 350 (1963).

In his treatise Professor Davis states:

> "The conclusion seems rather fully supported that a party who has a sufficient interest or right at stake in a determination of governmental action should have an opportunity for a trial type of hearing on issues of adjudicative facts".

He further concludes:

> "When adjudicative facts are in dispute, our legal tradition is that the party affected is entitled not only to rebut or explain the evidence against him but also to 'confront his accusers' and to cross-examine them".
>
> 1 Davis, *Administrative Law*, p. 426.

The April 3, 1963, action was taken *ex parte*, with-
›ut prior notice to appellants, and without a hearing.
lt was arbitrary in every sense. This was recognized
›y the Secretary in his decision of February 3, 1965
(Exh. E), at which time he "set aside" the earlier
lecisions and remanded the case "for initiation and
›rosecution of a contest".

I. THERE WAS NO "CONTEST OR PROTEST" PENDING WHEN APPELLANTS FILED THEIR COMPLAINT IN THE DISTRICT COURT.

Even if the April 3, 1963, action by the Riverside
.and Office was lawful action, it still appears that no
contest or protest" was pending against appellants'
ntries on May 13, 1965, the date appellants filed their
omplaint in the District Court.

Appellee's February 3, 1965, decision states that "the
Bureau *should initiate* contest proceedings against
ıe entries to the extent to which they are believed to
e invalid. Upon the filing of a proper and timely
nswer by the Zwangs, the cases will proceed to a
earing in accordance with the Department's contest
rocedures. 43 CFR, Subpart 1852." (Exh. E, p. 2;
nphasis supplied.) "Therefore, pursuant to the au-
ıority delegated to the Solicitor by the Secretary of
ıe Interior (210 DM 2.2A(4) (a); 24 F.R. 1348),
ıe decision appealed from is set aside and the case is
manded *for the initiation and prosecution* of a con-
st against each entry as provided in this decision."
Exh. E, p. 3; emphasis supplied.)

The point is, the initiation of contests four year after the date of the receipt is barred. 43 U.S.C. § 116 provides that "after the lapse of two years from th date of the issuance of the receipt" and "when ther shall be no pending contest or protest", patent shal issue.

A good illustration is the decision of the Minnesot Supreme Court in *Everett v. Wallin,* 184 N. W. 95 (1921).

In *Everett v. Wallin,* Everett's predecessor in in terest was an entryman. The following events tool place:

1. *August 17, 1906:* The receipt was issued to th entryman.

2. *November 23, 1906:* Wallin filed a private co test.

3. *December 11, 1906:* Wallin's contest was r jected by the General Land Office. The case was r ferred to a government special agent for investigatio of possible fraud by the entryman.

4. *February 11, 1907:* Another private contest wa filed.

5. *June 16, 1907:* The second contest was suspende pending an investigation of the entry on behalf the government.

6. *February 24, 1908:* A third private contest wa filed.

7. *June 3, 1908:* The second contest was permitte to proceed.

8. *February 4, 1909:* The second contest was dis-
nissed for want of prosecution.

9. *April 29, 1909:* The third contest was denied.

10. *June, 1909:* The government filed a contest.

The government's contest resulted in cancellation of he entry. After the cancellation, Wallin, who had een the first contestant, took up the entry and later btained a patent to it.

Everett, the successor of the original entryman, filed n action in a Minnesota Court, claiming that when on April 29, 1909, the third contest was denied, more han two years had elapsed from the date of the re-eipt; there was no contest or protest pending after he April 29, 1909, decision was made; the entryman vas entitled to patent at that time, and the June, 1909, government contest proceedings were barred by 43 U.S.C. § 1165 and were a nullity. Everett asked the Minnesota Court to quiet his title against Wallin. The Minnesota Court did so.

II. THE DISTRICT COURT HAD JURISDICTION TO GRANT PLAINTIFFS' REQUEST AND SHOULD HAVE DONE SO.

The United States Supreme Court has ruled in his area on four occasions: *United States ex rel. Champion Lumber Co. v. Fisher,* 227 U.S. 445, 33 S. Ct. 329, 57 L. Ed. 591 (1912); *Lane v. Hoglund,* 244 U.S. 174, 37 S. Ct. 558, 61 L. Ed. 1066 (1917); *Payne v. Newton,* 255 U.S. 438, 41 S. Ct. 368, 65 L. Ed. 720 (1920); and *Stockley v. U.S.,* 260 U.S. 532, 67 L. Ed. 390 (1923). The *Champion Lumber Co.* and *Lane*

cases probably are the leading ones. *Payne* and *Stockley* follow *Lane.*

In *Champion Lumber Co.,* the receiver's receipt was dated September 24, 1902. In November, 1902, the Commissioner of the General Land Office (the predecessor of today's Director of the Bureau of Land Management) received official reports indicating fraud on the part of the entryman. The entry was suspended pending further investigation. Further investigation was made, but it was not until 1906 that the Commissioner ordered a proceeding to be commenced against the entry. Notice was given and a hearing was held. As the result of the hearing, the entry was cancelled.

The entryman then filed an action in the Supreme Court of the District of Columbia, relying on 43 U.S.C. § 1165, to obtain a Writ of Mandate requiring the Secretary of the Interior to issue a patent for the land involved. The entryman's petition was dismissed in the Supreme Court of the District of Columbia. The dismissal was affirmed by the Court of Appeals for the District of Columbia. (39 App. D.C. 158.) In its opinion the United States Supreme Court declines to review the ruling of the Court of Appeals. The opinion stresses Section 250 of the Judicial Code of 1911, regulating review by the United States Supreme Court of Judgments of the Court of Appeals for the District of Columbia, but it also contains language to the effect that the determination of what constitutes a protest within the meaning of 43 U.S.C. § 1165 is a matter to be decided by the Secretary of the Interior, not by the Courts.

In *Lane,* during the two years after the issuance of the receipt, a forest officer reported that the entryman had not established or maintained a residence upon the land claimed by him, as the law required. After the expiration of the two years, the Commissioner of the General Land Office ordered a proceeding to be commenced in the local Land Office against the entry. Notice was given and a hearing was held. The local Land Office and the Commissioner found in favor of the entryman. However, the Secretary of the Interior found against the entryman and directed that the entry be cancelled. The entryman then filed a petition in the federal Court for a Writ of Mandate, on the basis of the provisions of 43 U.S.C. § 1165.

The question in *Lane* was whether the forest officer's report during the two years was a contest or protest within the meaning of 43 U.S.C. § 1165. The entryman contended that it was not. The Secretary of the Interior contended that it was.

The Supreme Court undertook to decide the question. It decided that the forest officer's report was not contest or protest, and directed the issue of patent.

The facts in *Champion Lumber Co.* and in *Lane* are strikingly similar. The results are different.

It is submitted that although *Lane* does not expressly overrule *Champion Lumber Co.,* it does so by clear implication. *Lane* stands for the proposition that what is a "contest or protest" within the meaning of 43 U.S.C. § 1165 is a matter for judicial inquiry. What is involved is construction of a statute. Statutory construction is not an exercise of administrative

judgment or discretion. (*Udall v. Wisconsin, Colorado and Minnesota,* 306 F. 2d 790, at 793 (C.A. D.C. 1962).)

The district judge resolved the conflict between the two cases by stating in his Memorandum Opinion (R. 42) as follows:

> "When the Lane case, supra, is read with the Champion Lumber Co. case, supra, it appears that the determination of whether a protest or contest has, in fact, been instituted, within the statutory period, lies within the discretion of the Secretary unless his conclusion can be said to be capricious or arbitrary or so unreasonable as not to be tenable."

Assuming *arguendo* that the district judge is correct, it still follows that the relief prayed for should be granted in the present case.

As has been pointed out, the "action" of April 3, 1963, was unquestionably arbitrary in that it neither was nor is authorized by the pertinent regulations, and was taken *ex parte,* without prior notice, and without a hearing. It is hard to conceive of anything more arbitrary. There is a good statement of this in the recent case of *Stewart v. Penny,* 238 F. Supp. 821, at 827 (D. Nev. 1965):

> "The omnipotence of the Department of the Interior as guardian of the public domain is exhibited when the Department acts affirmatively and grants patents under the public land laws. The converse is not true. An entry or application for patent which is contested or rejected by the Secretary presents issues regarding the legal

rights of the entryman under the public land laws. These are rights established by Congress which the Secretary of the Interior may not arbitrarily or capriciously ignore and which must be determined within the due process safeguards of the Administrative Procedure Act.

"Subordinately, the Government argues that the hearing held on Stewart's application was not a hearing required by statute within the meaning of the Administrative Procedure Act and that the Act, therefore, does not apply. This we cannot accept. The Administrative Procedure Act applies to 'each authority of the Government of the United States', not expressly excepted (5 U.S.C. § 1001). Adams v. Witmer (9 CCA 1958), 271 F. 2d 29, is direct authority for its applicability to the Secretary of the Interior."

Defendant's refusal on March 5, 1965, to issue patents (Exh. G), can not be viewed in a vacuum. It states that "the Land Office decision of April 3, 1963, was a protest action that would toll the two year patent entitlement period, as it was taken within the two year period". If as is contended, the April 3, 1963, action was arbitrary and capricious, the March 5, 1965 refusal, which is based on it, is no less arbitrary or capricious.

IV. EXHAUSTION OF ADMINISTRATIVE REMEDIES IS NOT REQUIRED; AND IF REQUIRED, PLAINTIFFS HAVE DONE SO.

In *Lane v. Hoglund,* supra, the entryman sought judicial relief on the basis of 43 U.S.C. § 1165 as soon as his entry was cancelled because allegedly he did not maintain a residence on it. In the words of the United States Supreme Court, "the present petition was then filed". The Court's opinion makes it clear that if at the expiration of two years there is no "pending contest or protest", the Secretary of the Interior has no discretion or judgment to exercise. He can do but one thing, issue a patent, and the act he is called upon to perform is a ministerial one.

The provisions of 43 C.F.R. 1862.6 bear this out. The regulation quotes from *Payne v. Newton,* supra, and says that the purpose of 43 U.S.C. § 1165 was to transfer from the land officers to the regular judicial tribunals after the passing of the specified two year period, the authority to deal with any subsequent controversy over the validity of the entry.

Also as noted early in this brief, there are no questions of fact involved in this case. The only questions are of law.

Prior administrative adjudication is not required for controversies which involve issues of law and do not involve issues essentially of fact or call for exercise of administrative discretion.

> *Gt. Northern Ry. Co. v. Merchants Elev. Co.,* 259 U.S. 285, at p. 291, 42 S. Ct. 477, 66 L. Ed. 943;

Pan American World Airways v. Boyd, 207 F. Supp. 152, at p. 160 (D. of C., 1962);
S.S.W. v. Air Transport Assn., 91 F. Supp. 269, at p. 270 (D. of C., 1950).

The rule just stated is applied and followed in the recent decision in *Greene v. United States,* 376 U.S. 149, 84 S. Ct. 615, 11 L. Ed. 2d 576 (1964).

Statutory construction is not an exercise of administrative judgment or discretion. (*Udall v. Wisconsin, Colorado and Minnesota,* supra.)

In any event appellants have already treaded their way through the tortuous paths of the administrative hierarchy. They did so in order to obtain a determination that the April 3, 1963, action was a nullity.

In this regard, the decision of the Riverside Land Office dated May 8, 1962 (Exh. A), concludes with the words, "the right of appeal is allowed . . .". It was appealed. The April 3, 1963 action of the same office (Exh. C) says that "Elodymae Zwang and Darrell Zwang are allowed the right of appeal . . .". It was appealed. The decision of the Bureau of Land Management dated October 23, 1963 (Exh. D), affirming the April 3, 1963, action, concludes with the same language. It was appealed, and on February 3, 1965, was "set aside" and "remanded for the initiation and prosecution of a contest". (Exh. E.)

The March 5, 1965, refusal to issue patents (Exh. G), contains no such language. It states: "It is assumed that this matter was reviewed by the Secretary when decision A-30201 was being considered". The

Secretary has already reviewed the matter. There is no reason to ask the Secretary to do something he has done already.

CONCLUSION

It is submitted that the judgment of the District Court should be reversed and the case remanded with instructions to the District Court to enter judgment as prayed for in appellants' amended complaint. Approximately five years have elapsed since May, 1961, when appellants filed their final proofs and received receipts. The government has yet to commence a proceeding against appellants' entries of a kind either authorized in the government's regulations or meeting basic standards of due process.

Dated, Coalinga, California,
May 2, 1966.

Frame & Courtney,
Ted R. Frame,
Attorneys for Appellants.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Ted R. Frame,
Attorney for Appellants.

(Appendix Follows)

Appendix.

Appendix

TABLE OF EXHIBITS

Exhibit	Record Page	Transcript Pages
Joint #A (Land Office Decision)	Attached to Pre-Trial Conference Order	........*
Joint #B (B.L.M. Decision)	Attached to Pre-Trial Conference Order	....
Joint #C (Land Office Decision)	Attached to Pre-Trial Conference Order	....
Joint #D (B.L.M. Decision)	Attached to Pre-Trial Conference Order	....
Joint #E (Secretary of Interior Decision)	Attached to Pre-Trial Conference order	....
Joint #F (Letter to Department of Interior)	Attached to Pre-Trial Conference Order	....
Joint #G (Reply to letter)	Attached to Pre-Trial Conference Order	....

*No reporter's transcript involved.

No. 20,844

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

DARRELL ZWANG and ELODYMAE ZWANG,

APPELLANTS

v.

STEWART L. UDALL, as SECRETARY OF THE INTERIOR OF THE UNITED STATES OF AMERICA,

APPELLEE

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA CENTRAL DIVISION

BRIEF FOR THE APPELLEE

EDWIN L. WEISL, JR.,
Assistant Attorney General.

MANUEL L. REAL,
United States Attorney,
Los Angeles, California, 90012.

RICHARD J. DAUBER,
Assistant United States Attorney,
Los Angeles, California, 90012.

ROGER P. MARQUIS,
GEORGE R. HYDE,
Attorneys, Department of Justice,
Washington, D. C., 20530.

I N D E X

	Page
inion below	1
risdiction	1
estion presented	2
atute involved	2
atement	2
mmary of argument	6
gument:	
I. The district court has no jurisdiction to review a determination of the Bureau of Land Management that a protest was pending within the meaning of 43 U.S.C. sec. 1165	8
A. The Secretary of the Interior has been charged by Congress with the responsibility for the administration and disposition of public lands	8
B. The Secretary of the Interior has exclusive jurisdiction to determine whether a protest has been raised within the meaning of 43 U.S.C. sec. 1165	10
C. The decision of the Land Office Manager, dated April 3, 1963, is a protest within the meaning of 43 U.S.C. sec. 1165	13
II. If this Court finds that the district court has jurisdiction, the appellants must first have exhausted their administrative remedies to invoke that jurisdiction	20
A. Appellants have not exhausted their administrative remedies	20
B. The decision of the Land Office of April 3, 1963, was not arbitrary in the sense that it would give the district court jurisdiction	22

Page

C. Appellants did not timely raise their claim to patents, regardless of the validity of their entries ---------------------- 24
Conclusion ---------------------------- 28

CITATIONS

Cases:

Best v. Humboldt Mining Co., 371 U.S. 334 ----------------------------- 9, 10
Brown v. Hitchcock, 173 U.S. 473 ------- 10
Cameron v. United States, 252 U.S. 450 - 9
Champion Lumber Co. v. Fisher, 227 U.S. 445 ----------------------------- 11
Coy v. Folsom, 228 F.2d 276 ------------ 21
Davis v. Nelson, 329 F.2d 840 ---------- 21, 25
Lane v. Hoglund, 244 U.S. 174 ---------- 7, 13, 15,
Standard Oil Co. of California v. United States, 107 F.2d 402, cert. den., 309 U.S. 654 ---------------------------- 11
Union Oil Company of California v. Federal Power Commission, 236 F.2d 816, cert. den., 352 U.S. 969 ------------ 21
United States ex rel. Alaska Smokeless Coal Co. v. Lane, 250 U.S. 549 ------- 10
United States ex rel. Hall v. Payne, 254 U.S. 343 ---------------------------- 10
United States ex rel. McBride v. Schurz, 102 U.S. 378 ------------------------- 10
United States ex rel. Riverside Oil Co. v. Hitchcock, 190 U.S. 316 ---------- 10

Statutes and Regulations:

R.S. sec. 441 -------------------------- 9
R.S. sec. 453 -------------------------- 9

:atutes and Regulations cont'd: Page

R.S. sec. 2478 ----------------------------	9
5 U.S.C. sec. 485 -------------------------	9
43 U.S.C. sec. 2 --------------------------	9
43 U.S.C. sec. 1165 -----------------------	6,7,8,10,13,19,20,24,25
43 U.S.C. sec. 1201 -----------------------	9
43 C.F.R. sec. 1842.2 ---------------------	27
43 C.F.R. sec. 1852.1-2 -------------------	18
43 C.F.R. sec. 1852.1-3 -------------------	19

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 20,844

DARRELL ZWANG and ELODYMAE ZWANG,

APPELLANTS

v.

STEWART L. UDALL, as SECRETARY OF THE INTERIOR OF THE UNITED STATES OF AMERICA,

APPELLEE

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA CENTRAL DIVISION

BRIEF FOR THE APPELLEE

OPINION BELOW

The district court's memorandum opinion is set out at pages 42-51 of the record.

JURISDICTION

Jurisdiction and venue of the district court were invoked by the appellants under 28 U.S.C. secs. 1331, 1346(a)(2) and 1391(e). Judgment of the district court was entered on

February 23, 1966 (R. 57). Notice of appeal was filed on March 2, 1966 (R. 59). This Court's jurisdiction rests on 28 U.S.C. sec. 1291.

QUESTION PRESENTED

Whether the district court correctly held it was without jurisdiction to determine whether a protest was pending within the meaning of 43 U.S.C. sec. 1165 and that this was a matter exclusively delegated to the Secretary of the Interior for determination.

STATUTE INVOLVED

43 U.S.C. sec. 1165 provides in pertinent part:

> That after the lapse of two years from the date of the issuance of the receipt of such officer as the Secretary of the Interior may designate upon the final entry of any tract of land under the homestead, timber-culture, desert-land, or preemption laws, or under the Act of March 3, 1891, and when there shall be no pending contest or protest against the validity of such entry, the entryman shall be entitled to a patent conveying the land by him entered, and the same shall be issued to him; * * *.

STATEMENT

This action in the nature of mandamus was instituted to compel the Secretary of the Interior to issue patents to

the appellants for entries made under the Desert Land Entry Act, 43 U.S.C. secs. 321 et seq., in addition to lands for which appellants will receive patents. 43 U.S.C. sec. 1165 provides for the issuance of patents if no protest or contest is pending after the passage of two years from the date of issuance of the receipt of final proof. Appellants maintained that no contest or protests had been made and that they, as a matter of law, were entitled to patents. This case was submitted to the district court on memoranda and briefs (R. 53) and a pretrial conference order.

The undisputed facts, as contained in the Pretrial Conference Order (R. 20-22), are as follows:

> A. Desert land entries comprising 320 acres each in the N ½ and the S ½ Sec. 19, T. 4S., R. 16 E., S.B.M., an oversize section in Riverside County, California, were allowed January 6, 1955, and subsequently assigned to plaintiffs, the Zwangs, who are husband and wife.
>
> B. Final proofs were submitted on May 17, 1961. The register's receipt is dated May 29, 1961.
>
> C. By decision dated May 8, 1962, the Land Office at Riverside rejected the final proofs.

D. The Zwangs appealed to the Director, Bureau of Land Management.

E. On October 10, 1962, the Division of Appeals, Office of the Director, reversed the decision of the Land Office and remanded the cases to the Land Office for further consideration.

F. On April 3, 1963, the Land Office accepted the final proofs for 80 acres in each entry and cancelled the entries as to the remaining lands.

G. The decision of April 3, 1963, was made by the Land Office <u>ex parte</u>, without a hearing and without prior notice to the Zwangs. A hearing was not waived by the Zwangs. The decision of April 3, 1963, was made by the Land Office based upon the records and documents contained in its files.

H. The Zwangs appealed again to the Director, Bureau of Land Management, and requested a hearing. On October 23, 1963, the Division of Appeals, Office of the Director, denied the Zwangs' request for a hearing and modified and affirmed the decision of the Land Office.

I. The Zwangs then appealed to the Secretary of the Interior, who issued his decision on February 3, 1965.

J. At the time the Zwangs filed their complaint herein, no contest within the framework of 43 CFR 1852.2-2 had been filed. None has been filed since.

K. The Zwangs have not received patents for their entries.

L. The Zwangs' request for patents covering 320 acres on each entry was denied by the Land Office on March 5, 1965.

M. Stewart L. Udall is the Secretary of the Interior.

The district court, in its "Memorandum Opinion For Use in Preparation of Findings of Fact, Conclusions of Law and Judgment" (R. 42), after reciting the above facts then quoted the pertinent part of 43 U.S.C. sec. 1165 (Br. 2) as follows:

> * * * <u>when there shall be no pending contest or protest against the validity of such entry</u> * * *. [Emphasis ours.]

The district court reviewed the principal authorities submitted by briefs of counsel and concluded (R. 50-51):

> When the Lane case, supra, is read with the Champion Lumber Co. case, supra, it appears that the determination of whether a protest or contest has, in fact, been instituted, within the statutory period, lies within the discretion of the Secretary unless his conclusion can be said to be capricious or arbitrary or so unreasonable as not to be tenable. From the foregoing authorities, the court concludes that the determination of whether the action of the Secretary of April 3, 1963,

> amounts to a protest is for the Commissioner, under the supervision of the Secretary of the Interior, to decide and that this Court is without jurisdiction to determine whether the action of the Land Office on April 3, 1963, constituted a protest.

The district court, after finding that it lacked the jurisdiction in this case to determine whether a protest had been made, stated (R. 51):

> If, as contended by plaintiffs, this court has the jurisdiction to determine the question of whether the cancellation on April 3, 1963, of the entries involved, other than for the 80 acres approved, the court would conclude that the said action, from which plaintiffs appealed, was a "protest" within the meaning of Section 1165 and that the Government is not required to file a "contest" as provided for in 43 C.F.R. §1852.2-2 to stop the running of the two year period concerned.

This appeal followed (R. 59).

SUMMARY OF ARGUMENT

I

The district court has no jurisdiction to review a determination of the Bureau of Land Management that a protest was pending within the meaning of 43 U.S.C. sec. 1165. Congress has charged the Secretary of the Interior with the responsibility for the administration and disposition of public lands.

The Secretary of the Interior has been given the exclusive jurisdiction to determine whether a protest has been raised within the meaning of 43 U.S.C. sec. 1165.

The Land Office Manager's decision, dated April 3, 1963, is a protest within the meaning of 43 U.S.C. 1165. The Supreme Court, in Lane v. Hoglund, 244 U.S. 174 (1917), has considered the question as to what is, and who may institute, a protest. The action taken by the Land Office Manager, a "public agent," in rejecting the submitted final proofs clearly is a "proceeding in the public right against an existing entry," Lane v. Hoglund, 244 U.S. 174, p. 178, which would have taken out of operation the subject statute.

If the courts have jurisdiction over this matter, then the appellants must first have exhausted their administrative remedies to invoke that jurisdiction.

The decision of the Land Office has not been shown to be arbitrary or capricious in the sense that the courts would have a limited jurisdiction to review it.

The appellants have not timely raised their claim to patents under 43 U.S.C. sec. 1165. The failure of the

appellants to appeal from the Land Office Manager's rejection of their demand for patents to the Director of the Bureau of Land Management and the Secretary precludes them from raising for the first time in the courts the rejection of their demand for the issuance of patents under 43 U.S.C. sec. 1165. This attempt of the appellants to raise in the courts the denial by the Land Office Manager of the demand for patents is nothing but an attempt to bypass the Director of the Bureau of Land Management and the Secretary of the Interior, who have often been designated by the courts as a "special tribunal" on public land matters.

ARGUMENT

I

THE DISTRICT COURT HAS NO JURISDICTION TO REVIEW A DETERMINATION OF THE BUREAU OF LAND MANAGEMENT THAT A PROTEST WAS PENDING WITHIN THE MEANING OF 43 U.S.C. SEC. 1165

A. The Secretary of the Interior has been charged by Congress with the responsibility for the administration and disposition of public lands. - The Secretary of the Inter[illegible] has been "charged with the supervision of public business

relating to * * *. The public lands, * * *." R.S. sec. 441; 5 U.S.C. sec. 485. The Commissioner of the General Land Office, under the direction of the Secretary of the Interior, is directed to "perform all executive duties * * * in anywise respecting * * * public lands and the issuing of patents * * *." R.S. sec. 453; 43 U.S.C. sec. 2. He is expressly "authorized to enforce and carry into execution, by appropriate regulations, every part of the provisions of * * * [the Title dealing with public lands] not otherwise provided for." R.S. sec. 2478; 43 U.S.C. sec. 1201.

The Supreme Court, in Cameron v. United States, 252 U.S. 450 (1920), at pages 459-460 stated the proposition that:

> By general statutory provisions the execution of the laws regulating the acquisition of rights in the public lands and the general care of these lands is confided to the land department, as a special tribunal; and the Secretary of the Interior, as the head of the department, is charged with seeing that this authority is rightly exercised to the end that valid claims may be recognized, invalid ones eliminated, and the rights of the public preserved. Rev. Stats., §§ 441, 453, 2478; United States v. Schurz, 102 U.S. 378, 395; Lee v. Johnson, 116 U.S. 48, 52; Knight v. United States Land Association, 142 U.S. 161, 177, 181; Riverside Oil Co. v. Hitchcock, 190 U.S. 316.

See also Best v. Humboldt Mining Co., 371 U.S. 334, 337 (1963).

The authority given the Secretary of the Interior to supervise the administration and disposal of the public lands of the United States is quasi-judicial, and may not be interfered with through mandamus or injunction processes unless his conclusions can be said to be arbitrary or capricious. United States ex rel. Riverside Oil Co. v. Hitchcock, 190 U.S. 316 (1903); United States ex rel. McBride v. Schurz, 102 U.S. 378 (1880); Brown v. Hitchcock, 173 U.S. 473 (1899); United States ex rel. Alaska Smokeless Coal Co. v. Lane, 250 U.S. 549 (1919); United States ex rel. Hall v. Payne, 254 U.S. 343 (1920).

B. The Secretary of the Interior has exclusive jurisdiction to determine whether a protest has been raised within the meaning of 43 U.S.C. sec. 1165. - "So long as the legal title remains in the Government all questions of right should be solved by appeal to the land department and not to the courts." Brown v. Hitchcock, 173 U.S. 473, 477 (1899); Best v. Humboldt Mining Co., 371 U.S. 334, 338 (1963). This Court has long recognized the limited function of the courts

in matters involving public lands. In Standard Oil Co. of California v. United States, 107 F.2d 402, 409 (1940), cert. den., 309 U.S. 654, this Court stated:

> The disposal of the public lands is not a subject over which the "judicial power" of the United States is extended. It is a field in which the authority of the Congress is supreme. Lee v. Johnson, 116 U.S. 48, 6 S.Ct. 249, 29 L.Ed. 570; Art. IV, sec. 3, clause 2, of the Constitution, U.S.C.A.

In Champion Lumber Co. v. Fisher, 227 U.S. 445 (1913), a proceeding in mandamus to compel the Secretary of the Interior to issue a patent, when the dispute concerned the same issue as here--whether there had been a "protest" within the meaning of the two-year statute--the Supreme Court, in denying the petition for allowance of writ of error for lack of jurisdiction under Section 250 of the Judicial Code, took occasion to quote in part with apparent approval from the appellate court opinion (227 U.S. 448-449):

> "Every point advanced by appellant in this case is, in our view, settled by the following very recent decisions: Fisher v. Grand Rapids Timber Co., 37 App.D.C. 436; Ness v. Fisher, 223 U.S. 683; McKensie v. Fisher, 39 App.D.C. 7. In

Fisher v. Grand Rapids Timber Co., which involved the interpretation of the very statute upon which appellant here relies, this court, speaking through Mr. Justice Van Orsdel said: 'While it is true that arbitrary power resides nowhere in our system of government, and while the supervisory authority vested in the Secretary of the Interior and the Commissioner of the General Land Office over the disposition of the public lands is neither unlimited nor arbitrary, yet the question here presented as to whether or not the communication and order amounted to a protest, which we regard as exceedingly close, was one clearly within the power of the Commissioner to decide. To say that he was mistaken would require us to review a matter exclusively confided by law to his discretion and judgment. This proceeding will not admit of such a review.'

"The communications of Special Agent Hammer respecting this entry were made within the two years contemplated by said act of March 3, 1891, as was the communication of June 18, 1904, from the Commissioner to said agent. It is apparent that these communications resulted in the withholding of a patent; in other words, that the Commissioner regarded the right to that patent as dependent upon the outcome of the investigation which was to ensue. The subsequent decision of the Secretary that what was done within the two-year period constituted a protest against the patenting of the entry, was not arbitrary or capricious, but was based upon evidence; and the sufficiency of that evidence was for his and not our determination."

The portion of the decision quoted by the Supreme Court clearly sets forth the legal principle which is involved in this appeal and concludes that this is "a matter exclusively confided by law to his [the Secretary's] discretion and judgment."

Appellants' argument that the Champion case by implication is overruled by Lane v. Hoglund, 244 U.S. 174 (1917), overlooks the difference in facts of the two cases noted by the district court (R. 50).[1/] In the Lane case, no proceeding was begun within the two-year period, leaving no room for the exercise of judgment on the part of the Secretary. In the Champion case, within the two-year period proceedings had been instituted looking to an investigation of an alleged fraud.

C. The decision of the Land Office Manager, dated April 3, 1963, is a protest within the meaning of 43 U.S.C. sec. 1165. - Final proofs were submitted by the appellants on

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1/ Of course, overruling of a unanimous decision directed solely at this one issue, sub silentio in an opinion four years later, is not to be assumed.

May 17, 1961. The register's receipt is dated May 29, 1961, from which the two-year period must run. The Land Office, Riverside, California, by decision dated May 8, 1962 (R. 26-A), rejected the final proofs and cancelled the entries in their entirety, because the proofs submitted showed that the reclamation of the lands entered had not been accomplished during the statutory life of the entries. That decision, on appeal, was reversed and the cases remanded by the office of the Director of the Bureau of Land Management, for further consideration in light of additional information furnished by the appellants (R. 26-D). A further decision was then issued by the Land Office, dated April 3, 1963 (R. 26-C), accepting the final proofs as to 80 acres of land in each entry and rejecting the proofs and cancelling the entries as to the remai ing lands therein. 2/ That decision, on appeal, was sustained as modified by the office of the Director of the Bureau of Land Management (R. 26-H). The Assistant Solicitor, Land Appeals, office of the Secretary, by decision dated February 3,

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2/ There is no dispute in this case concerning the two 80-acre tracts.

1965 (R. 26-J), set aside the Land Office and Director's decisions and remanded the cases to the Land Office for the institution of contest proceedings "at which expert testimony and other evidence can be submitted and subjected to cross-examination and rebuttal" (R. 26-M), to resolve the factual dispute. Both of the Land Office decisions rejecting the final proofs and cancelling in part the entries were issued prior to the expiration of two years from the date final receipts had been issued.

The appellants here have overlooked the concise language in the opinion written by Mr. Justice Van Devanter in Lane v. Hoglund, 244 U.S. 174 (1917), where the question as to what constitutes a contest and a protest and by whom they may be instituted is considered. The Court there stated (pp. 178-179):

> As applied to public land affairs the term "contest" has been long employed to designate a proceeding by an adverse or intending claimant conducted in his own interest against the entry of another, and the term "protest" has been commonly used to designate any complaint or objection, whether

> by a public agent or a private citizen, which is intended to be and is made the basis of some action or proceeding in the public right against an existing entry. This explains the use in the statute of both terms in the disjunctive, and accords with the instructions of May 8, 1891, 12 L.D. 450, wherein each term is spoken of as meaning a "proceeding" under the Rules of Practice to cancel or defeat an entry, and wherein it is said that "when there are no proceedings initiated within that time [the two years] by the government or individuals the entryman shall be entitled to patent." The same view is shown in the supplemental instructions of July 1, 1891, 13 L.D. 1, wherein the Secretary said to the Commissioner: "You will, therefore, approve for patent all entries against which no proceedings have been, or shall be, begun within the specified period, the entry will be held to have been taken out of the operation of this statute, and such cases will proceed to final judgment as heretofore."

After discussing departmental decisions and the facts of the case before it, the opinion continued (p. 181):

> Looking, then, at the statute in the light of all that bears upon its purpose and meaning, we think it certainly and unmistakably lays upon the Secretary of the Interior, as the head of the Land Department, a plain duty to cause a patent to be issued to a homestead entryman whenever it appears, as concededly it did in this instance, that two years

> have elapsed since the issue of the receiver's receipt upon the final entry and that during that period no proceeding has been initiated or order made which calls in question the validity of the entry. In the exercise of its discretion Congress has said, in substance, by this statute that for two years after the entryman submits final proof and obtains the receiver's receipt the entry may be held open for the initiation of proceedings to test its validity, but that if none such be begun within that time it shall be passed to patent as a matter of course.

It is clear in the present instance that protests had been instituted against the subject entries within two years of proofs of final submission and in fact are still pending. There is no requirement in the statute that the protests or contests be valid or upheld to toll the statute.

It is true that technical contest proceedings which have been ordered by the Secretary within the purview of the departmental regulations have not yet been initiated against the entries in question. This is immaterial here since the entries have been under official challenge since May 8, 1962, and the statute is inapplicable.

Contrary to appellants' assertion that there is no provision in the regulations for a government protest (Br. 10) 43 C.F.R. sec. 1852.1-2, entitled "Protests," provides as follows:

> Where the elements of a contest are not present, any objection raised by any person to any action proposed to be taken in any proceeding before the Bureau will be deemed to be a protest and such action thereon will be taken as is deemed to be appropriate in the circumstances.

This provision certainly encompasses the objections raised by the two decisions of the Land Office and is consistent with the quoted portion of Lane v. Hoglund, supra. The Government does not have to initiate a formal contest as to a record matter. The decisions of May 8, 1962, and April 3, 1963, were both stated to be based upon facts apparent from the final proofs submitted by the appellants. These decisions in no wise were based on information obtained from field examinatio or conflicting factual evidence. The fact that the April 3, 1963, decision was not issued pursuant to information obtaine from field examinations was clearly recognized by the Department of the Interior in its February 3, 1965, decision (A-302

(R. 26-M). A notice and hearing, therefore, were not thought to be required in connection with the decisions of the Land Office. Contests are instituted and hearings held normally where factual matters are contested. In the Land Office decisions no facts were considered to be contested. The fact that the Secretary remanded these cases for the instituting of a contest only shows that the Secretary considered that there was a factual dispute needing to be resolved. In this case, by service of the adverse decisions of the Land Office the appellants were notified of the protest to their entries which preclude 43 U.S.C. sec. 1165 from operating so as to entitle the appellants to a patent. Whether the action taken was valid or not it was a protest and tolled the statute.

The district court recognized that if the Government could not rely on "protest" as distinguished from "contest," as treated in 43 C.F.R. sec. 1852.1-3, then the appellants' contentions would be correct (R. 45). The district court, however, concluded that, if the court had the jurisdiction to determine the question of whether a "protest" had been made

within the meaning of 43 U.S.C. sec. 1165, it would have concluded that the action of the Land Office on April 3, 1963, cancelling the entries, was a protest within the meaning of 43 U.S.C. sec. 1165 and the Government was not required to file a technical contest to stop the running of the two-year period concerned (R. 51).

II

IF THIS COURT FINDS THAT THE DISTRICT COURT HAS JURISDICTION, THE APPELLANTS MUST FIRST HAVE EXHAUSTED THEIR ADMINISTRATIVE REMEDIES TO INVOKE THAT JURISDICTION

A. <u>Appellants have not exhausted their administrative remedies</u>. - Assuming for purposes of argument only[3/] that the district court had jurisdiction, it is a well-established principle of law that no one is entitled to judicial relief until the prescribed administrative remedies have been exhausted. This requires not merely the initiation of efforts to secure administrative review but the pursuing of them to

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3/ The district court did not rule on this ground, in view of its finding of no jurisdiction (R. 51).

their conclusion in the administrative agency prior to seeking judicial intervention. Union Oil Company of California v. Federal Power Commission, 236 F.2d 816 (C.A. 5, 1956), cert. den., 352 U.S. 969 (1957); Coy v. Folsom, 228 F.2d 276 (C.A. 3, 1955); Davis v. Nelson, 329 F.2d 840 (C.A. 9, 1964).

The decision of the Assistant Solicitor, dated February 3, 1965, has remanded the subject cases to the Land Office for the express purpose of instituting a contest proceeding to resolve the factual issues involved. The administrative process in these cases will not be exhausted until a final and definitive decision is issued pursuant to evidence adduced at a hearing bearing on the reclamation accomplished. Appellants are simply trying to short-cut the administrative process, which can possibly lead to an award to them of the land they desire, without the necessity of court proceedings. The doctrine of exhaustion of administrative remedies is designed precisely for the purpose of preventing such possible useless endeavor by the court.

B. The decision of the Land Office of April 3, 1963, was not arbitrary in the sense that it would give the district

court jurisdiction. - In the first place, the decision of April 3, 1963, has been set aside by the Secretary and the case remanded. This action of the Secretary renders moot any suggestion that the action of the administrative agency was arbitrary and capricious, thereby giving the court a limited jurisdiction over this matter.

In the second place, the decision of the Land Office was not a final administrative decision. Any appeal taken from it to a court necessarily would be premature and subject to dismissal for failure to have exhausted an administrative remedy.

In this case, appellants appealed to the Secretary and succeeded in having the Land Office decision set aside. It cannot now be seriously urged that this action of the Land Office is arbitrary and capricious, so that a court can exercise its limited jurisdiction to review administrative actions to ascertain whether they are arbitrary or capricious.

The action of the Land Office, in fact, was not arbitrary when it "without notice and hearing" rendered its decisi

of April 3, 1963. That decision was made based on matters within the record before the Land Office which was considered sufficient to warrant the action taken. The Secretary concluded, however, differing with both the Land Office and the Bureau of Land Management, that there was a question of fact to be decided and a hearing required. The Secretary made no finding that the decision was arbitrary or capricious. The normal Land Office procedure is to treat matters in as expeditiously a manner as possible. Where matters of record would require an entry to be rejected and cancelled, no useful purpose would be served to have a contest and a hearing (R. 26-I). In this instance, the Secretary found that the issue was not one to be resolved by the record and ordered a contest be initiated to resolve a question of fact. Aside from the fact that the decision of the Secretary set aside the Land Office decision and that of the Bureau of Land Management, the Land Office decision was never shown to be arbitrary or capricious. All one can say is that the judgment of the Land Office as to whether a factual issue was present in the case differed with the Secretary's.

C. <u>Appellants did not timely raise their claim to patents, regardless of the validity of their entries</u>. - The appellants herein, after the Secretary of the Interior had remanded this controversy for the holding of a hearing as to contested factual questions, for the first time asserted the claim that the Secretary of the Interior was obliged to issue to them patents under 43 U.S.C. sec. 1165, without regard to those factual questions. The statute provided for the issuance of patents on the basis of the passage of time, regardless of whether there had been compliance with certain minimum requirements with respect to cultivation. The Land Office Manager, on March 5, 1965 (R. 26-P), responded to the appellants' demand (R. 26-O) for the immediate issuance of patents by stating:

> * * *, the Land Office decision of April 3, 1963 was a protest action that would toll the two year patent entitlement period, as it was taken within the two year period.
>
> Therefore, the entrymen are not entitled to patent on this premise.

The Manager then speculated that:

> It is assumed that this matter was reviewed by the Secretary when decision A-30201 was being considered. 4/

This request for patents under 43 U.S.C. sec. 1165 and the decision to not respond to appellants' demands was the first time in this proceeding that the question presented by this appeal had been raised. Notwithstanding speculation of the Manager of the Land Office, this matter was not ruled on or considered by the Secretary.

This adverse decision of the Land Office has now become a final administrative action and the failure of appellants to perfect an appeal to the Director and the Secretary precludes them from raising for the first time this issue in the courts.

This Court in Davis v. Nelson, 329 F.2d 840 (1964), treated a similar situation at page 847, where it said:

> Procedural errors, no matter how serious, are subject to correction on administrative review equally with erroneous determinations of fact

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4/ It is clear that appellants' present approach would modify the Secretary's decision and the purpose of the reversal.

and law after hearing. We cannot assume that improvident or illegal action by the manager would not be summarily reversed by the Director or Secretary. Plaintiffs first must follow the course of administrative procedure to finality before appealing to the courts for relief. Myers v. Bethlehem Shipbuilding Corp. (1938), 303 U.S. 41, 58 S.Ct. 459, 82 L.Ed. 638; Brown v. Hitchcock (1899), 173 U.S. 473, 19 S.Ct. 485, 43 L.Ed. 772; Interstate Natural Gas Co. v. Southern California Gas Co. (9 CCA 1953), 209 F.2d 380; Olinger v. Partridge (9 CCA 1952), 196 F.2d 986. This is so even if a claim of unconstitutionality is asserted against the administrative process. Monolith Portland Midwest Co. v. Reconstruction Finance Co. (9 CCA 1949), 178 F.2d 854; Aircraft & Diesel Equipment Corp. v. Hirsch (1947), 331 U.S. 752, 67 S.Ct. 1493, 91 L.Ed. 1796. The Administrative Procedure Act (5 U.S.C. § 1009) expressly provides that "any preliminary, procedural, or intermediate agency action or ruling not directly reviewable shall be subject to review upon the review of the final agency action", and includes within the scope of judicial review of any "final agency action" power to set aside agency action taken "without observance of procedure required by law." The special issues presented by the Third Cause of Action of the Complaint fall before the requirement that plaintiffs must pursue and exhaust their administrative remedies to finality.

Accordingly, when the administrative remedies provided within the Department of the Interior are not fully pursued, it must be held that appellants are barred from any judicial review of this administrative action.

It is of no matter, that there was no statement at the end of the Manager's response to the demand that he issue patents to the appellants, which advised appellants of their right of appeal.

Appellants are well aware of the proper procedure to be followed in appealing from an adverse action. It may be noted also that appellants have the right of appeal from any adverse action not by virtue of the statement usually attached to the end of Interior decisions. It is provided in 43 C.F.R. sec. 1842.2 that any party adversely affected by a decision of an officer of the Bureau of Land Management shall have a right of appeal to the Director. Certainly the Director and the Secretary, not the Court, are the ones to whom appellants should go to ascertain what the Secretary earlier had decided. Instead, this suit was filed just a little more than two months after the Manager's response to their demand.

CONCLUSION

For the foregoing reasons, it is submitted that the judgment of the district court should be affirmed.

Respectfully,

EDWIN L. WEISL, JR.,
Assistant Attorney General.

MANUEL L. REAL,
United States Attorney,
Los Angeles, California, 90012.

RICHARD J. DAUBER,
Assistant United States Attorney,
Los Angeles, California, 90012.

ROGER P. MARQUIS,
GEORGE R. HYDE,
Attorneys, Department of Justice,
Washington, D. C., 20530.

MAY 1966.

CERTIFICATE OF EXAMINATION OF RULES

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

GEORGE R. HYDE
Attorney, Department of Justice
Washington, D. C., 20530.

No. 20,844

United States Court of Appeals

For the Ninth Circuit

DARRELL ZWANG and ELODYMAE ZWANG, *Appellants,* vs. STEWART L. UDALL, as Secretary of the Interior of the United States of America, *Appellee.*	

On Appeal from the United States District Court
for the Southern District of California,
Central Division
Honorable E. Avery Crary, Judge

APPELLANTS' REPLY BRIEF

FRAME & COURTNEY,
330 North Fifth Street,
P. O. Box 895,
Coalinga, California,
Attorneys for Appellants.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO

Subject Index

	Page
Summary of argument	1
Argument	1
I. The statute required a hearing	1
II. The April 3, 1963, action was a nullity	2
III. The running of 43 U.S.C. § 1165 was not tolled	3
IV. There was no administrative remedy to exhaust	3
V. Other points raised by appellee lack merit	4
VI. Appellee easily could have prevented the running of 43 U.S.C. § 1165	5
Conclusion	6

Table of Authorities Cited

Cases

Cases	Pages
Adams v. Witmer, 271 F. 2d 29 (C.A. 9, 1958)	2, 3
Anglo-Canadian Shipping Co., Ltd. v. Federal Maritime Comm., 310 F. 2d 606 (C.A. 9, 1962)	6
Best v. Humboldt Placer Mining Co., 371 U.S. 334, 83 S. Ct. 379, 9 L. Ed. 2d 350 (1963)	3
Burnett v. New York Central Railroad Co., 380 U.S. 424, 85 S. Ct. 1050 (1965)	3
Cameron v. United States, 252 U.S. 450, 40 S. Ct. 410 (1920)	3
Lane v. Hoglund, 244 U.S. 174, 37 S. Ct. 615, 61 L. Ed. 1066 (1917)	4, 5
Lillibridge v. Riley, 316 F. 2d 232 (C.A. 5, 1963)	3
Morgan v. United States, 298 U.S. 468, 56 S. Ct. 906, 80 L. Ed. 1288 (1936)	2
Morgan v. United States, 304 U.S. 1, 58 S. Ct. 773, 82 L. Ed. 1129 (1937)	2, 3
O'Boyle v. Coe, 155 F. Supp. 581 (W.D. Mo. 1957)	5
Payne v. Newton, 255 U.S. 438, 41 S. Ct. 368, 65 L. Ed. 720 (1920)	3
Stewart v. Penny, 238 F. Supp. 821 (D. Nev. 1965)	2

Regulations

43 C.F.R. 1852.1-2	4
43 C.F.R. 1852.2	2
43 C.F.R. 1862.6	2

Statutes

Administrative Procedure Act (5 U.S.C. § 1001, et seq.)	2
43 U.S.C., Section 1165	2, 3, 4, 5

No. 20,844

United States Court of Appeals

For the Ninth Circuit

Darrell Zwang and Elodymae Zwang,
Appellants,

vs.

Stewart L. Udall, as Secretary of the Interior of the United States of America,
Appellee.

On Appeal from the United States District Court for the Southern District of California, Central Division
Honorable E. Avery Crary, Judge

APPELLANTS' REPLY BRIEF

SUMMARY OF ARGUMENT

The "action" of April 3, 1963, was a nullity. Since it was a nullity it did not toll the limitation period. Upon the expiration of the limitation period, appellants were and are entitled to patents. Other points raised by appellee have no merit.

ARGUMENT

I. THE STATUTE REQUIRED A HEARING.

The central fact in this case is that the so-called "action" of April 3, 1963, was taken *ex parte,* with-

out prior notice, and without a hearing. The applicable statute required a hearing. This is true whether the applicable statute is 43 C.F.R. 1852.2, entitled "Government contests", or whether it is the more general Administrative Procedure Act (5 U.S.C. § 1001, et seq.). *Adams v. Witmer,* 271 F. 2d 29 (C.A. 9, 1958); *Stewart v. Penny,* 238 F. Supp. 821 (D. Nev. 1965). It is recognized by appellee in his decision of February 3, 1965 (Exh. E), wherein he states that factual disputes must be resolved "in accordance with the Department's contest procedures".

II. THE APRIL 3, 1963, ACTION WAS A NULLITY.

In the famous *Morgan* case Chief Justice Hughes wrote:

> "Nor is it necessary to go beyond the terms of the statute in order to consider the constitutional requirements of due process as to notice and hearing. For the statute itself demands a full hearing and the [Secretary's] order is void if such a hearing was denied". *Morgan v. United States,* 298 U.S. 468, 477, 479, 481, 56 S. Ct. 906, 80 L. Ed. 1288 (1936).

This is probably as far as it is necessary to go to decide this case. It really matters little whether the label used is "protest", "contest" or something else. What is void is void, whether for the purpose of 43 U.S.C. § 1165, or for any other purpose. As pointed out in one of the late *Morgan* cases, failure to afford the opportunity for a hearing is more than a procedural irregularity. It is a vital defect. *Morgan v.*

United States, 304 U.S. 1, 14, 22, 58 S. Ct. 773, 82 L. Ed. 1129 (1937).

Consideration of the broader concept of due process leads to the same result. *Cameron v. United States,* 252 U.S. 450, 459-460, 40 S. Ct. 410, 412 (1920); *Best v. Humboldt Placer Mining Co.,* 371 U.S. 334, 337, 83 S. Ct. 379, 9 L. Ed. 2d 350 (1963); *Adams v. Witmer,* supra.

III. THE RUNNING OF 43 U.S.C. § 1165 WAS NOT TOLLED.

43 U.S.C. § 1165 is a statute of limitation. Statutes of limitation are not tolled by action which is a nullity! *Lillibridge v. Riley,* 316 F. 2d 232, 233 (C.A. 5, 1963).

The basic question to be answered in determining, whether, under a given set of facts, a statute of limitation is to be tolled, is one of legislative intent whether the right shall be enforceable after the prescribed time. *Burnett v. New York Central Railroad Co.,* 380 U.S. 424, 426, 85 S. Ct. 1050 (1965). The legislative intent is clear here: The lapse of two years after the issuance of the receipt will bar a contest or protest based on any charge whatsoever. *Payne v. Newton,* 255 U.S. 438, 41 S. Ct. 368, 65 L. Ed. 720 (1920).

IV. THERE WAS NO ADMINISTRATIVE REMEDY TO EXHAUST.

As has been pointed out, the April 3, 1963, action was a nullity. 43 C.F.R. § 1862.6 plainly states that the purpose of 43 U.S.C. § 1165 is to "transfer from

the land officers to the regular judicial tribunals the authority to deal with any subsequent controversy over the validity of the entry, as would be the case if the patent were issued in the absence of the statute".

V. OTHER POINTS RAISED BY APPELLEE LACK MERIT.

Appellee's statement that he has been charged by Congress with the responsibility for the administration and disposition of public lands is true, but the generality does not apply to the facts of this case.

Appellee argues in several places that the action of April 3, 1963, was a "protest" within the meaning of 43 U.S.C. § 1165. The action was null and void. In any event 43 C.F.R. 1852.1-2, cited by appellee (Br. 18), does not support appellee's argument. 43 C.F.R. 1852.1-2 is a subdivision of 43 C.F.R. 1852.1. 43 C.F.R. 1852.1 is entitled "*Private* contests and protests". It refers to "objection . . . to any action proposed to be taken in any proceeding before the Bureau". The April 3, 1963, action was not an objection to action proposed to be taken in a proceeding before the Bureau. It was (or rather, purported to be) the action itself.

In support of his "protest" argument, appellee quotes in part (Br. 15-16) from *Lane v. Hoglund,* 244 U.S. 174, 37 S. Ct. 615, 61 L. Ed. 1066 (1917). It is readily apparent, however, that the Rules of Practice referred to in the quotation from *Lane* (Br. 16) are not the same as the current Public Administrative Procedures set out in 43 C.F.R. Group 1800. *Lane* was

decided 21 years before the enactment of the Code of Federal Regulations, and when the C.F.R. was enacted the Administrative Procedure Act (5 U.S.C. § 1001, et seq.) was still a gleam in its mother's eye.

What *Lane* does stand for is that judicial inquiry is not only proper in this area, but as well often necessary to correct palpable administrative abuse.

Appellee also mentions the Land Office decision of May 8, 1962 (Br. 18; Exh. A). The reason for mentioning it is obscure. It was reversed on October 10, 1962, was of no further moment, and is not one of the issues set forth in the Pre-Trial Order (R. 20).

Appellee seemingly overlooks the point that even if the April 3, 1963, action *was* a "contest or protest" within the meaning of 43 U.S.C. § 1165, it was set aside on February 3, 1965, and on February 4, 1965, more than two years after the issuance of the receipt, the entries stood unchallenged. They stand unchallenged today.

VI. APPELLEE EASILY COULD HAVE PREVENTED THE RUNNING OF 43 U.S.C. § 1165.

All appellee had to do to prevent the running of the limitation period was to follow the law and the regulations. That he chose not to is certainly no fault of appellants. As stated in *O'Boyle v. Coe,* 155 F. Supp. 581, 584 (W.D. Mo. 1957):

> "The administrative discretion, however, is not unlimited or unbridled. It must be a sound legal discretion. Whether a dispensation should be

> granted is not a matter of grace, but must be determined on sound legal principles. In a democratic society the acts of government officials are not based on grace but on established principles of law".

See also, *Anglo-Canadian Shipping Co., Ltd. v. Federal Maritime Comm.*, 310 F. 2d 606, 613 (C.A. 9, 1962).

CONCLUSION

Appellants are entitled to patents for their entries.

Dated, Coalinga, California,
June 20, 1966.

FRAME & COURTNEY,
By TED R. FRAME,
Attorneys for Appellants.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

TED R. FRAME,
Attorney for Appellants.

No. 20,845

United States Court of Appeals

For the Ninth Circuit

KENT-REESE ENTERPRISES, INC., RAYMOND DOUGLASS and ROBERT REESE,
Appellants,

vs.

WALTER HEMPY, Trustee of Big Boy Markets, Inc., Bankrupt,
Appellee.

APPELLANTS' OPENING BRIEF

C. WADSWORTH WHITE,
1330 Broadway,
Oakland, California 94612,
Attorney for Appellants.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO

Subject Index

Page

Jurisdiction of proceedings 1

Statement of the case 2

Specification of errors 4

Argument of case and law 5

Conclusion 13

Table of Authorities Cited

Cases

Pages

First National Bank v. Consolidated Lumber Company (1911) 16 Cal.App. 267, 116 Pac. 608 6

Lambert v. Haskell (1889) 80 Cal. 611, 22 Pac. 327 6

Codes

Civil Code, Section 2837 6

28 United States Code:
- Section 1291 1
- Section 1294 1
- Section 1331 1
- Section 1334 1

11 United States Code (Bankruptcy Act):
- Section 1, Subsection 30 9

Texts

46 Cal. Jur. 2d 244, Section 35 6

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- Page 122 12
- Page 322 12

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Earl A. Saliers, PhD. and Arthur W. Holmes, Basic Accounting Principles, p. 601 .... 11, 12

No. 20,845

United States Court of Appeals

For the Ninth Circuit

Kent-Reese Enterprises, Inc., Raymond Douglass and Robert Reese,
Appellants,

vs.

Walter Hempy, Trustee of Big Boy Markets, Inc., Bankrupt,
Appellee.

APPELLANTS' OPENING BRIEF

JURISDICTION OF PROCEEDINGS

Sections 1331 and 1334 of Title 28 of the United States Code are the basis for the jurisdiction of the U. S. District Court, Northern District of California, Southern Division, in which this case originated.

This appellate case being an appeal from that Court and relating to the subject matter described below, the United States Court of Appeals for the Ninth Circuit properly has jurisdiction of this appeal under the provisions of Title 28 of the United States Codes, § 1291 and § 1294.

This jurisdiction is supported: (I) By the allegations of the COMPLAINT (Tr. pp. 1-4) which state

(a) That Plaintiff HEMPY's Bankrupt (i.e., BIG BOY MARKETS, INC.) filed a voluntary bankruptcy petition in the U. S. District Court, Northern District of California, Southern Division, on October 19, 1960, and was adjudged to be bankrupt by that Court (Tr. p. 7); (b) That Plaintiff was the Trustee, in said bankruptcy, duly appointed (Tr. p. 2); (c) That said Bankrupt was a California Corporation, and (d) That Plaintiff claimed a fraudulent transfer of property of the alleged value of $41,000 as a violation under Bankruptcy Act sections 67e and 70e (Tr. pp. 1-3; paragraphs I, VIII, XII); and by (II) The admissions of the ANSWER (Tr. pp. 5, 6) which admitted jurisdictional allegations but denied the other matters.

STATEMENT OF THE CASE

As was concisely and comprehensively reviewed and well stated by the Trial Judge in his Findings of Fact (Tr. pp. 7-11) and as Appellants will endeavor to summarize with emphasis on the principal issue, this case involves the legal effect of the guarantee agreement dated November 1, 1959 (Tr. pp. 8a, 9) made by and with the Bankrupt at that time when Bankrupt was solvent and operating two super markets at Santa Rosa, California. In each of these markets, Appellant KENT-REESE ENTERPRISES, INC. (hereinafter called "KENT-REESE") was an independent entity operating, as a tenant, the off-sale liquor business (Tr. p. 2, Findings 5).

Bankrupt then owed Appellants DOUGLASS and REESE \$30,700 (Tr. pp. 8a, 9; Findings 6, 7, 8) which money had been deposited by them with the Bankrupt in late 1958 and early 1959 for the purchase of preferred stock of Bankrupt. Bankrupt had been unable to obtain the prerequisite authorization from the State of California to permit issuance of such stock. After depositing this stock-purchase money for that purpose, they had later permitted Bankrupt to use those funds in its business upon a temporary demand-loan basis.

In the latter part of 1959, Bankrupt wanted to continue having the use of this money while it continued to seek authorization for the preferred stock issuance. Appellants DOUGLASS and REESE were unwilling to forego their right to its return *unless* Appellant KENT-REESE would guarantee to them that KENT-REESE would repay that money to them if Bankrupt should fail to pay them. (Tr. pp. 8a, 9; Findings 6, 7, 8.) At that time Appellant KENT-REESE owed Bankrupt a balance exceeding \$30,700 on a \$54,000 promissory note and it was willing to guarantee such repayment upon condition that Bankrupt would grant KENT-REESE the right to apply against said promissory note balance any sums which it became responsible thereunder to pay to Appelants DOUGLASS and REESE (Tr. pp. 8a, 9; Findings 7, 8).

This three-way arrangement had been orally agreed upon between the parties and thereafter was reduced to writing by the November 1, 1959, written guarantee contract (EXHIBIT 15 at the trial) which is the

principal document involved in these proceedings (Tr. pp. 3-4; Findings 7, 8).

After said agreement, Bankrupt's efforts to obtain authorization for issuance of preferred stock were unsuccessful and the $30,700 continued to be owing to Appellants DOUGLASS and REESE.

About one year after the written guarantee agreement, Bankrupt filed its petition in bankruptcy (Tr. p. 10; Findings 10, 11) and Appellants DOUGLASS and REESE made demand upon Appellant KENT-REESE for their money. They did not file claims in bankruptcy stating that they felt they were secured creditors through the guarantee. Appellant KENT-REESE subsequently paid them for the account of the Bankrupt on the basis of said guarantee and refused to pay the promissory note balance of $31,000 to the Trustee in Bankruptcy. It based its actions upon the guarantee contract and its right to offset against the unpaid promissory note balance the amounts so paid to Appellants DOUGLASS and REESE who received those payments (Tr. pp. 10, 11; Findings 11, 12) and also have refused to deliver this money to the Trustee.

SPECIFICATION OF ERRORS

I. Appellants particularly except to and specify as erroneous the *Conclusions of Law* set forth as Conclusions numbered (2) (starting after its first sentence) and (3), (4), (6), (7) and (9). (Tr. pp. 11-13) and the judgment in its entirety.

The essence of the appeal and of the error specified (as is also set forth in "STATEMENT OF POINTS ON WHICH APPELLANTS INTEND TO RELY ON APPEAL" attached to the transcript which would be pp. 24 and 25, as added) is *that the Nov. 1, 1959, guarantee agreement did,* in fact and in law, *effect a present and effective transfer at that time*—and not a transfer imputed to "immediately prior to filing in bankruptcy," as was concluded by the Trial Judge.

ARGUMENT OF CASE AND LAW

The applicable laws of two fields appear to affect the making of a correct decision on this determinative point and question: Did the November 1, 1959, guarantee agreement effect a transfer of an asset or of an interest in an asset, by the then-solvent Bankrupt on that date?

(1) The first and basic relevant field of law is the California State law, i.e.: Under California law is such a guarantee, or pledge of an account receivable in the possession of the pledgee, operative and effective to transfer to the party guaranteed, or the pledgee, immediately an interest in the subject asset?

The California courts have constantly recognized that a guarantee is, by its very nature, conditioned upon the occurrence of a possible or contingent future event but that the guarantee becomes a recognized and existing contract obligation as of the date of its execution.

As stated in the summary of California law in 46 Cal.Jur.2d at page 244 under the subject "Suretyship and Guaranty", § 35, in which encyclopedia it is earlier discussed that California treats guaranty and surety contracts similarly, it is stated:

> "The liability on a suretyship obligation commences with the giving of the undertaking though it is unenforceable until the principal obligation matures."

Cited on this point particularly are *Lambert v. Haskell* (1889) 80 Cal. 611, 22 Pac. 327 and *First National Bank v. Consolidated Lumber Company* (1911) 16 Cal.App. 267, 116 Pac. 608.

In the *Lambert v. Haskell* case concerning the interpretation of a surety agreement to be effective upon the continuation of a temporary injunction, the Court stated (pp. 617, 618), that ". . . in interpreting the terms of a contract of suretyship the same rules are to be observed as in the case of other contracts", citing Civil Code § 2837 and further stating:

> "One of these rules is that a contract must be interpreted so as to make it operative and capable of being carried into effect, if it can be done without violating the intention of the parties. (Civil Code § 1643.)"

More directly to the point, in *First National Bank v. Consolidated Etc.*, the defendant corporation had sold plaintiff a promissory note and defendant corporation and stockholders too guaranteed its future payment with the words: "For value received, we hereby guarantee the payment of the within note at

maturity . . ." (i.e., about six months after assignment). The defendants pleaded the defense of the three-year limitation of actions. The Court stated (pp. 268, 269):

> "It is quite true that the liability incurred by the Newport Lumber Company was not enforceable until the maturity of the note and default made by the makers thereof. It cannot be said, however, that the liability was not created until such time. Liability does not depend for its existence upon the fact that it is immediately enforceable. It may exist without the right of immediate enforcement. (*White v. Green*, 56 Iowa 176, 74 N.W. 928; *Hunt v. Ward*, 99 Cal. 612, 37 Am.St.Rep. 87, 34 Pac. 335.) In the latter case it is stated, 'A liability may be absolute or contingent; it may be conditional or limited; it may be presently enforceable by action or there may be time given for its performance; of whatever its character, it is created by the consummation of the contract, act, or omission by which the liability is incurred.' Under the terms of the contract, the liability incurred by the Newport Lumber Company was absolute, although the right of the plaintiff to enforce such liability depended upon a contingency, namely: the default of the makers of the note; but this fact did not render the liability contingent. There is a marked distinction between a contingent liability and the right contingent upon the happening of an event to enforce an existing liability. In the one case, there is no liability until the happening of the event, the occurrence of which creates the liability, while in the other a liability exists, but the right to enforce it depends upon the con-

> tingency. Here there was an existing indebtedness in a sum specified in the note which the makers promised to pay to the holder thereof. By its contract of guaranty the corporation agreed that it would pay this indebtedness when the note was due, if the makers of the note failed to pay it. It follows, we think, that the liability was created on August 31, 1905, at a time when the corporation by contract obligated itself to make the payment. If this be true, the cause of the action to enforce defendant's statutory liability as a stockholder of the Newport Lumber Company was barred in three years from said date."

This is still the California law on this point, unchanged by the statutory elimination (in 1939) of the difference between guarantee and surety contracts.

(2) The second field is the federal law of the Bankruptcy Act which applies to the extent that it sets up the standards or characteristics for the claimed offense: the fraudulent transfer—which the Trial Court in this case only found to be fraudulent because the transfer was imputed, technically, to have incurred at a fictitious time, "immediately prior to bankruptcy" rather than on or before November 1, 1959.

Granting that under California law the guarantee contract (which in this case was even more enforceable because the Bankrupt's $31,000 promissory account receivable asset was in the possession of the recipient of the Bankrupt's guarantee, KENT-REESE) was immediately operative and effective to

give KENT-REESE the benefit of that guarantee should the condition stated therein later occur, then this guarantee contract was immediately a fully effective "transfer" under the Bankruptcy Act and was not operative and effective at a fictitious, imputed future date.

The express provisions of the Bankruptcy Act defining a "transfer" in the applicable parts thereof (Title 11, Chapter 1 entitled "Definitions," § 1 under the title, "Meaning of Words and Phrases", subsection 30) read:

> "(30) 'Transfer' shall include the sale and every other and different mode, direct or indirect, of . . . *parting with property or with an interest therein . . . or of fixing a lien upon* property or upon *an interest therein,* absolutely *or conditionally,* voluntarily or involuntarily, by or without judicial proceedings, as a conveyance . . ., payment, *pledge,* mortgage, *lien, encumbrance,* gift, *security or otherwise;* the retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by such debtor."

Even if we disregard the California law making a guarantee an immediately-effective contract and creating immediately an obligation against the maker's assets and consider only the express wording and definitions quoted above, it would seem clear that the November 1, 1959, contract (Tr. pp. 8a, 9; Finding 7) effected a "transfer" as that term is used in the Bankruptcy Act.

The written contract of November 1, 1959 (Exhibit 15), expressly and explicitly gave to Appellant

KENT-REESE, and to Appellants DOUGLASS and REESE as the third party beneficiaries of that guarantee, a lien upon the money which Appellant KENT-REESE owed to the Bankrupt. Appellant KENT-REESE, in order to reimburse itself for making good its guarantee to them, had the right to offset against the Bankrupt the amount of its obligations to DOUGLASS and REESE.

By express terms of this agreement, on the date of its execution, the Bankrupt certainly parted with an interest in the KENT-REESE promissory note obligation to the Bankrupt, and fixed a lien upon that asset in the hands of KENT-REESE as the recipient of the Bankrupt's contract and guarantee, even though the lien was subject to future conditions which might or might not occur.

Certainly *this contract* obligation effected *a pledge* and the giving of *a lien,* and *encumbrance* or *security,* to KENT-REESE.

All of these are clearly within the express provisions of the Bankruptcy Act set forth above and recognize as a transfer the giving of rights in or control over the asset of the (later) Bankrupt.

(3) Possibly there arose in the mind of the Trial Judge, or there may arise in the minds of the Justices of the Circuit Court of Appeals questions such as: Doesn't this recognition of such an immediate effect to a guarantee conditioned on a future contingency conflict with the economic realities of business? Or: In view of the fact that the guarantee-activating conditions actually occurred later when the

guarantor was insolvent, isn't the recognition of the effectiveness of the guarantee agreement as of the date of its execution an unrealistic technicality?

The answers to both questions would be "no." The presumption which might make such questions seem equitable or reasonable does not exist. In business and in accounting practices concerning businesses whenever an asset is subjected to any conditions or contingencies which might affect its future liquidity, or availability, etc., *they are immediately recognized as affecting that asset.*

If we look to authorities in the accounting and auditing fields to see whether or not the creation of such a contingent liability is recognized by accountants and auditors as affecting assets and properties immediately upon the creation of the contingent liability, we find that what the Bankruptcy Act recognizes as a "transfer" at the time it is made is also recognized by these authorities as affecting the asset.

In "ACCOUNTING FOR LAWYERS" by E. McGruder Faris, Jr., LL.M., Professor of Law at Wake Forest College, published in 1964, this authority says under the heading "Contingent Liabilities," page 347, and under the sub-title "Presenting Contingent Liabilities by Means of Accounting Entries":

> "The amount of a contingent liability is removed from net worth pending the actual outcome of the contingency."

In the book "BASIC ACCOUNTING PRINCIPLES" by Earl A. Saliers, Ph.D. CPA, Professor

of Accounting at Louisiana State University, co-authored by Arthur W. Holmes, B.S.C., Assistant Professor of Accounting at the University of Cincinnati, under the heading, "Analysis of Financial Statements," page 601, they state:

> "7. Contingent Liabilities.—Contingent liabilities should be shown somewhere in the balance sheet, or indicated by means of foot notes. Perhaps the most common ones are those arising in connection with notes receivable discounted, accounts receivable sold, and accommodation endorsements. Contingent liabilities are an uncertain factor on the balance sheet, but liberal allowance should be made for what may become a direct liability of the business."

One of the leading corporate and tax loan authors, Robert H. Montgomery, CPA, former President of the American Institute of Accountants and former Professor of Accounting at Columbia University, in the sixth edition (1940) of his book, "AUDITING THEORY AND PRACTICE" at page 122 under the title "Accounts Sold or Pledged", says:

> ". . . If the accounts are pledged to secure loans, the amount of the accounts pledged should be stated in the description of the assets . . ."

Further, under the title, "Contingent Liabilities," at page 322, discussing what matters should be reflected by proper accounting, he further writes:

> "As used in auditing procedure, the term 'contingent liabilities' includes (1) primary or direct liabilities which after date of the balance sheet (a) are determinable in amount but do not be-

come enforceable unless some future event occurs . . .

"*Primary Liabilities:* Class (2) includes secondary or indirect liabilities as to which no obligation exists unless and until the primary obligor defaults, such as: (i) . . . (ii) indorsement of notes for affiliated or subsidiary concerns; (iii) accommodation endorsement of accounts receivable or installment obligations when the transfer attaches a contingent liability; (v) . . ."

CONCLUSION

In summary, Appellants DOUGLASS and REESE in late 1958 and early 1959 deposited funds with Appellee's Bankrupt which they were entitled to have returned to them in 1959, upon demand; however, in 1959 at the request of the Bankrupt and solely for the benefit of the Bankrupt at a time when it was solvent, Appellants DOUGLASS and REESE agreed to forego their right to an immediate return of their money but only in consideration of the guarantee arrangements of the guarantee contract which is the subject of this appeal and the key to the correct decision (Tr. pp. 8a, 9; Findings 7, 8).

On the date of that contract, November 1, 1959, Appellant KENT-REESE committed itself to its obligations to DOUGLASS and REESE but it only undertook these obligations to them in consideration of and in reliance upon its contract right, should the conditions set forth in the agreement occur, to offset against the Bankrupt whatever amount the Bankrupt

might have failed to pay on its obligations to DOUGLASS and REESE, offsetting such amounts against the money which it (KENT-REESE) owed to the (then solvent) Bankrupt.

Under California law and under the express definition of a "transfer" by the Bankruptcy Act, this transaction was a legitimate business arrangement for the benefit of the (then solvent) Bankrupt and created contingent security lien rights which were operative and effective as of the date of the signing of that contract.

This transaction was a legitimate and proper business type of transaction to aid the (then solvent) Bankrupt and was accomplished by legal, proper and business-like means. The contract rights created, although contingent, were of a type occurring frequently in business and which accountants and auditors recognize as immediately affecting the assets involved.

To brand this transaction, which was helpful to the Bankrupt as a "fraudulent transfer" imputed to be effective at a later date through an improperly-applied legal fiction is unjust and an improper decision by the Trial Court in that regard.

At a time when Appellee's Bankrupt was solvent and operating two large markets, Appellant KENT-REESE incurred its obligations to DOUGLASS and REESE, which are contract obligations which it must honor and from which it cannot escape by reason of any legal fiction imputing to its side of this three-way contract any fraud or illegality.

Under a proper application of the State law and Bankruptcy Act provisions to the facts of this case, neither could the Bankrupt escape honoring the corollary pledge and contract obligations it made to KENT-REESE by its part in the guarantee contract.

In justice to the other contracting parties, the Appellants, the Bankrupt should be held to honor its contract validly entered into at a time when it was solvent and benefited therefrom.

Dated, Oakland, California,
July 12, 1966.

Respectfully submitted,
C. Wadsworth White,
Attorney for Appellants.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

C. Wadsworth White,
Attorney for Appellants.

No. 20,845

United States Court of Appeals

For the Ninth Circuit

KENT-REESE ENTERPRISES, INC., RAYMOND DOUGLASS and ROBERT REESE,
Appellants,

vs.

WALTER HEMPY, Trustee of Big Boy Markets, Inc., Bankrupt.
Appellee.

APPELLEE'S ~~REPLY~~ BRIEF

GERALD N. HILL,
435 Russ Building,
San Francisco, California 94104.

WILLIAM KELLY,
ROTHSCHILD & PHELAN,
155 Montgomery Street,
San Francisco, California 94104.

Attorneys for Appellee.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO

INDEX

Page

Jurisdiction 1

Statement of the Case 1

Statement of the Facts 3

Argument of Case and Law 4

Payment by Kent-Reese constituted a preference voidable under Section 60 of the Bankruptcy Act 4

A. All elements of a preference are present; transfer had not been perfected prior to bankruptcy since other creditors still had rights 4

B. Date of transfer of funds or credit controls and not date of surety agreement 8

C. There was no immediate transfer of possession, on November 1, 1959, as required under state law; the transfer is therefore voidable as a fraudulent conveyance 11

D. Assuming, arguendo, that the transfer gave rise to a mortgage, the mortgage is void 12

Conclusion 13

Table of Authorities Cited

Cases

Pages

American Surety Co. v. Sampsell, 327 U. S. 269, 90 L. Ed. 663 (1946) 11

Aulick v. Largent, 295 Fed. 2d 41 (1961) 5, 7

Davis v. Woolf, 147 Fed. 2d 629 (1945) 9

Hecht v. Smith, 183 Cal. App. 2d 723 (1960) 7

In Re Kaufman, 142 Fed. Supp. 759 (1956) 7, 10

In Re Quaker State Sheet Metal Co., 129 Fed. 2d 894 (1942) 6, 7, 10

Pennington v. Legg, 183 Fed. Supp. 884 (1960) 7

Walters v. Bank of America, 9 Cal. 2d 46, 69 Pac. 2d 839 (1937) 7

Wilson Brothers v. Nelson, 183 U. S. 191, 41 L. Ed. 147 (1901) 10

Statutes

11 United States Code (Bankruptcy Act):
- Chapters X, XI, XII, XIII 4
- Section 60 .... 2, 4
- Section 60a(2) 6

28 United States Code:
- Section 1291 1
- Section 1294 1
- Section 1331 1
- Section 1334 1

Civil Code of State of California:
- Section 2957 12
- Section 3440 .... 11, 12

Texts

3 Collier on Bankruptcy 758-9 4

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Appellee.

APPELLEE'S REPLY BRIEF

JURISDICTION

Jurisdiction is admitted by Appellants and has been at all stages of the proceedings. See Title 28 of the United States Code, Sections 1291, 1294, 1331 and 1334.

STATEMENT OF THE CASE

This is an appeal by the defendants from a judgment by the District Court declaring that certain transactions between the bankrupt, Big Boy Markets, Inc., the controlling directors, Raymond Douglass and Robert Reese, and another corporation controlled by the same two individuals, Kent-Reese Enterprises,

Inc., were preferential transfers in violation of the provisions of Section 60 of the Bankrupcy Act.

The Court indicated that the applicable law is authoritatively explained in the decision of *Aulick v. Largent* (1961) 295 Fed. 2d 41. That decision is not discussed or mentioned in appellant's opening brief.

The controversy stems from a document, introduced as Exhibit 15 in these proceedings, entitled "Receipt for Sum Deposited for Purchase of Preferred Stock; Guarantee of Repayment by Interested Corporation; and Provisions for Transfer of Credits, etc." This document was drafted by C. Wadsworth White, Esq., attorney for appellants herein, and attorney for all interested parties at the time of the transactions in question.

Appellee supports the trial court's findings that:

1. All elements of a voidable preference are present.

2. The transfer of the promissory note (which was the obligation of Kent-Reese to the bankrupt) to defendants Reese and Douglass took place immediately prior to the filing of the petition in bankruptcy, thus creating a voidable preference within four months of the filing of the petition in bankruptcy, despite the earlier date of the purported guaranty agreement.

3. The transfer was thus fraudulent against creditors and voidable by appellee.

The appellants' apparent claim that the guaranty agreement created an earlier security or "lien" (more than four months prior to the filing of the petition in

bankruptcy) is refuted by the absence of perfection under applicable state law.

The only real question is the date of the transfer of the promissory note (and the rights thereunder) for the purpose of determining whether a voidable preference was effected. The trial court found that the actual date of the transfer was immediately prior to the filing of the petition in bankruptcy and the findings of fact, which are unchallenged, support that result as does the applicable case law.

The interpretation of the pertinent document, in regard to any ambiguity therein, should and must be against the existing factual background. The two corporations were, in all respects, controlled by the individual appellants, Raymond Douglass and Robert Reese, who had the ability to arrange the corporate affairs in any way they chose. The ambiguous agreement and the other dealings were created by them at their pleasure and, therefore, in case of doubt, should be construed against them.

STATEMENT OF FACTS

Appellants, in their Specification of Errors (appellants' opening brief, pages 4-5), do not set forth as erroneous any of the findings of fact of the trial court; thus the findings of fact as set forth by the trial court should be accepted as true and correct for the purposes of this appeal.

We do not feel that the Statement of the Case, set forth by appellants on pages 2-5 of their opening

brief, is completely consistent with the facts as developed by the record or as found by the court. Therefore, the appellee adopts the findings of fact as set forth by the District Court without variation therefrom.

ARGUMENT OF CASE AND LAW

PAYMENT BY KENT-REESE CONSTITUTED A PREFERENCE VOIDABLE UNDER SECTION 60 OF THE BANKRUPTCY ACT.

A. All elements of a preference are present; transfer had not been perfected prior to bankruptcy since other creditors still had rights.

The elements of a preference are as follows: "a debtor (1) making or suffering a transfer of his property, (2) to or for the benefit of a creditor, (3) for or on account of an antecedent debt [resulting in a depletion of the estate], (4) while insolvent, and (5) within four months of bankruptcy or of the original petition under Chapters X, XI, XII, or XIII of the Act, (6) the effect of which transfer will be to enable the creditor to obtain a greater percentage of his debt than some other creditor of the same class." (3 *Collier on Bankruptcy*, pp. 758-9.)

All of the elements of the preference are admitted by Appellants except that the transfer of property by the bankrupt was made within four months of bankruptcy. Appellants contend that the transfer occurred earlier; i.e. element number (4) has been disputed. Before examining this crucial point, let us examine the authority relied upon by the court.

The present factual situation is strikingly similar to the situation considered by the Court of Appeals in the case of *Aulick v. Largent* (4 Cir.) 295 Fed. 2d 41 (1961). In that case the bankrupt was indebted to Aulick on a pre-existing unsecured indebtedness. Aulick was called upon to make good on this indebtedness. Following negotiation, it was agreed that Aulick would accept the bankrupt's personal note if endorsed by a third party, Lemley.

Lemley agreed to endorse the note if he was given certain corporate stock to secure his liability as an endorser. The security was given and the stock was pledged.

Bankruptcy followed within four months. Aulick recovered from Lemley on his guarantee.

The trustee in bankruptcy sued Aulick to recover the value of the stock on the theory that the pledge constituted a voidable preference in favor of Aulick. Judgment was entered in favor of the trustee and was affirmed as against Aulick upon appeal.

In both the *Aulick* case and the present case, all parties were aware of insolvency at the time of the transfer and insolvency existed without doubt. In both cases the transfer was on account of an antecedent indebtedness. In each case, the transfer was to a third party to secure a guarantee of the payment of the preexisting indebtedness.

The only difference between the *Aulick* case and the present case is the date of the pledge. In the *Aulick* case the pledge occurred within four months

of bankruptcy. In the present case the purported guaranty agreement was executed more than four months prior to bankruptcy, *but was never perfected as required by State law.*

Bankruptcy Act Section 60a(2) defines perfection for the purpose of determining whether a preference has been made. That section provides:

> "a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsquent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee."

When a transfer has not been so perfected, Section 60a(2) of the Bankruptcy Act provides:

> "If any transfer of real property is not so perfected against a bona fide purchase, or if any transfer of other property is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this Act, *it shall be deemed to have been made immediately before the filing of the petition.*" (Emphasis added.)

All of Appellants' discussion as to guarantees and suretyship is meaningless. The question is whether the creditors' rights of Douglass and Reese had been *perfected* at some period prior to the four-month period which would preclude a bona-fide purchaser or creditor from acquiring superior rights in the property transferred by the bankrupt. This is the final question presented in *In Re Quaker City Sheet Metal*

Co., 129 Fed. 2d 894 (1942) and *In Re Kaufman,* 142 Fed. Supp. 759 (1956). In those two cases under Pennsylvania and Kentucky law, respectively, it was found that the purchaser or creditor could have acquired superior rights.

In the instant case in effect a promissory note was returned, cancelled or set off as consideration for payment of the full amount due two creditors, Douglass and Reese, who obtained thereby a preference over other creditors. That it was a third-party beneficiary contract is of no moment. *Pennington v. Legg,* 183 Fed. Supp. 884 (1960) and *Aulick v. Largent,* supra.

The funds due on the promissory note as they became payable could be garnisheed by a creditor, *Walters v. Bank of America,* 9 Cal. 2d 46, 69 Pac. 2d 839 (1937), and a set-off can not be invoked to defeat this right. At page 57 the court said:

> To allow the garnishee to claim his right of set-off to defeat the claim of the creditor . . . would result in an unwarranted interference with the rights of other creditors of defendant. Its (garnishee's) liability is not determined by an agreement between itself and the judgment debtor as to the application of the fund, but by the law which defines its liability as such garnishee. . . .

The promissory note itself in the hands of Big Boy Markets could have been attached or sold until cancelled or surrendered. In *Hecht v. Smith,* 183 Cal. App. 2d 723 (1960), the court said, on page 726:

> A negotiable promissory note is something more than mere evidence of indebtedness. It is property

> which can be subject of manual delivery. . . . may be here attached in a proper case. . . . It [such a note] "is a promissory note, negotiable in form, which passes in the commercial world by indorsement and delivery and is subject to sale. . . ."

If the note had been sold or attached prior to insolvency neither the guaranty nor a subsequent right of set-off would have matured.

Thus the bona fide purchaser or creditor could have gained superior rights to the two creditors prior to the insolvency and within the four-month period.

B. Date of transfer of funds or credit controls and not date of surety agreement.

The District Court has found that the alleged agreement of November 1, 1959,

> "did not effectuate a present assignment or transfer of said promissory note concurrently with the execution of said agreement, and any such transfer is deemed by law to have been made immediately before the filing of the petition in bankruptcy." (Findings and Opinion, page 6, lines 28-32.)

This promissory note constituted the Kent-Reese obligation to Big Boy, the bankrupt. According to the District Court's findings, the transfer of the obligation from Big Boy to defendants Reese and Douglass then took place at that time—immediately prior to filing the petition in bankruptcy. Actual payment, of course, came some time later.

Thus the assignment at that time was a voidable preference and a fraudulent transfer under the Bankruptcy Act. (Findings and Opinion, page 7, lines 16-18.) This is a correct finding under applicable law.

The date of the agreement of indemnity, guaranty or surety is not controlling, but the date upon which the funds were transferred or the credit actually given does control. A somewhat analogous case is *Davis v. Woolf,* 147 Fed. 2d 629 (1945), which reads, on page 632:

> [T]he rule, for which there is ample authority, that if property is transferred to a surety after he has become bound upon his guaranty, in order to indemnify him from loss and the principal is insolvent at the time of the transfer, it is a preferential transfer and may be recovered by the trustee in bankruptcy of the principal under § 60, sub. a, of the Bankruptcy Act, 11 USCA § 96, sub. a, if the other conditions therein prescribed for a recoverable preference concur. . . .
>
> It is equally true that if a surety pays or provides funds for the payment of a debt and the principal transfers property to the surety to indemnify or reimburse him, this is a preference of the surety in the event of the principal's bankruptcy and the existence of the other conditions which are declared by the Bankruptcy Act to constitute a preference. [citations] In such case the estate of the bankrupt is not enhanced in the least by the money advanced by the surety at the time of the transfer because the surety receives property equal to the value of the money advanced and the only purpose and effect of the

> transaction is to substitute the surety as a principal creditor for the amount of the debt.

It was in the bankruptcy petition itself (which Douglass helped prepare) that the decision is revealed to treat the guaranty as coming into effect by not listing either the note as an asset or the claims of Douglass and Reese for the amounts previously advanced. Kent-Reese later paid the amounts represented by judgment herein to Douglass and Reese.

In *Wilson Brothers v. Nelson,* 183 U.S. 191, 46 L. Ed. 147 (1901), the agreement (power of attorney to take judgment at any time) was 13 years old, but was acted upon within the four-month restriction, and was declared a preference and against Congressional intent.

The question of creating secret liens is discussed in *In Re Quaker City Sheet Metal Co.,* supra, at page 896:

> [T]he purpose of Section 60, sub. a, as amended by the Chandler Act of 1938, was to strike down secret liens even though given for a present consideration.

Next, *In Re Kaufman,* supra, treats of equitable liens on page 760:

> [I]n 1950 Congress amended Section 60 of the Bankruptcy Act and it now provides that the recognition of equitable liens would be denied where available means of perfecting a legal lien have not been employed.

As previously mentioned, Kent-Reese made no claim for the amounts which it had to pay Douglass and Reese. In a surety bond case the United States Supreme Court barred such collection. *American Surety Co. v. Sampsell,* 327 U.S. 269, 90 L. Ed. 663 (1946).

The date of the transfer which would create a preference—namely, the treatment of the promissory note as fully set off by the amount due to Douglass and Reese—is clearly within the four-month period prior to the petition.

C. There was no immediate transfer of possession, on November 1, 1959, as required under state law; the transfer is therefore voidable as a fraudulent conveyance.

California Civil Code Section 3440, as of November 1, 1959, the date of the pertinent agreement, provided as follows:

> "Every transfer of personal property and every lien on personal property made by a person having at the time the possession or control of the property, and not accompanied by an immediate delivery followed by an actual and continued change of possession of the things transferred, *is conclusively presumed fraudulent and void as against the transferor's creditors* while he remains in possession and the successors in interest of those creditors, and as against any person on whom the transferor's estate devolves in trust for the benefit of others than the transferor and as against purchasers or encumbrancers in good faith subsequent to the transfer.
>
> Exceptions. This section shall not apply to any of the following:
>
> . . .

(c) *Mortgages allowed by law,* and contracts of bottomry or respondentia.

. . ." (emphasis added)

The bankrupt had possession of the promissory note at all times. There was no immediate transfer of possession.

Section 3440 holds that the transfer is a fraudulent conveyance, void as to creditors, *unless it is a mortgage.*

D. Assuming, arguendo, that the transfer gave rise to a mortgage, the mortgage is void.

California Civil Code Section 2957 provides that an unrecorded chattel mortgage is "void as against creditors of the mortgagor." (Civil Code Section 2957 subd. 4.) The mortgage is also void if not acknowledged or proved and certified in the same manner required of a deed of real property. (Civil Code Section 2957 subd. 1.) The mortgage is also void unless it is clearly marked "apart from and preceding all other terms of the mortgage, to be a mortgage of crops and chattels, or either." (Civil Code Section 2957, subd. 5.)*

---

*§2957. Essential elements; recording; re-recordation.

A mortgage of personal property or crops is void as against creditors of the mortgagor and subsequent purchasers and encumbrancers of the property in good faith and for value, unless;

1. It is acknowledged, or proved and certified, in like manner as grants of real property;

. . . .

4. The mortgage, if of personal property other than crops growing or to be grown or animate personal property, is recorded in the office of the recorder of the county where the property mortgaged is located at the time the mortgage is executed, and also in the county to which such property is there-

From the said agreement, it clearly appears:

(1) The document is unrecorded.

(2) The document was not acknowledged as required of deeds in California.

(3) The document is not entitled at the top, "Mortgage of Chattels."

Thus, if the document is a mortgage of chattels, it is void.

CONCLUSION

The only question at issue—at the time of giving a preference to appellants which would create a voidable preference constituting a transfer fraudulent against creditors—is settled in favor of appellee trustee in bankruptcy on several grounds:

1. The rights of the appellants were not perfected against other creditors until immediately prior to the filing of the petition in bankruptcy within the statutory four-month period;

2. The transfer of actual credits did not take place until immediately before the filing of the petition in bankruptcy which is the controlling date under case

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after removed, and also in the county where the mortgagor resides at the time the mortgage is executed; provided that in case the mortgagor is a nonresident of this State, the recordation of the mortgage in the county where the property is located at the time the mortgage is executed and also in the county to which such property is thereafter removed shall constitute compliance with the provisions of this section;

5. Each such mortgage is clearly entitled on the face thereof, apart from and preceding all other terms of the mortgage, to be a mortgage of crops and chattels, or either;

. . ."

law (and the actual funds were not transferred until a time after said petition had been filed);

3. The transfer of the rights to the promissory note which represented the obligation to the bankrupt were not perfected according to the applicable state law prior to the filing of the petition in bankruptcy.

Thus, the findings and opinion of the District Court in favor of appellee are fully substantiated.

It is respectfully submitted that the decision of the District Court be affirmed.

Dated, San Francisco, California,
November 12, 1966.

Respectfully submitted,
Gerald N. Hill,
William Kelly,
Rothschild & Phelan,
Attorneys for Appellee.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

William Kelly,
Attorney for Appellee.

No. 20,845

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For the Ninth Circuit

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Appellants,

vs.

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Appellee.

APPELLANTS' CLOSING BRIEF

C. WADSWORTH WHITE,
Suite 1043, 1330 Broadway,
Oakland, California 94612,
Attorney for Appellants.

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Subject Index

Page

Facts supporting appellants' appeal 1

Opposition arguments of reply brief:

Guaranty and security-offset agreement and rights thereunder were perfected when executed on Nov. 1, 1959 6

(A) Transfer was perfected when contract was executed 6

(B) Date of surety agreement controls effective date of transfer 14

(C) The Nov. 1, 1959 transfer was not voidable under California law 15

Conclusion 18

Table of Authorities Cited

Cases

Cases	Pages
Aulick v. Largent (1961) 295 Fed. 2d 41	6
Davis v. Woolf (1945) 147 Fed. 2d 629	14
Hauger v. Gates (1954) 42 Cal. 2d 752, 269 Pac. 2d 609	13
Hecht v. Smith (1960) 183 Cal. App. 2d 723, 7 Cal. Rptr. 209	13, 14
In re Douglas Estate (1961) 197 Cal. App. 2d 258, 17 Cal. Rptr. 89	17
In re Kaufmann (1956) 142 Fed. Supp. 759	7, 9
In re Quaker City Sheet Metal Co. (1942) 129 Fed. 2d 894	7, 8
Marroquin v. Barrial (1959) 174 Cal. App. 2d 540, 345 Pac. 2d 30	16
Obergfell v. Booth, 218 Ill. App. 492	12
Pedley v. Doyle (1918) 177 Cal. 284, 170 Pac. 602	17
Reios v. Mardis (1912) 18 Cal. App. 276, 122 Pac. 1091	17
Walters v. Bank of America (1937) 9 Cal. 2d 46, 69 Pac. 2d 839	10, 13

Codes

Civil Code:

Section 953	16
Section 3439.01	15
Section 3440	15

No. 20,845

United States Court of Appeals

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APPELLANTS' CLOSING BRIEF

The essence of Appellants' appeal is the belief that the trial court *erred in finding* that the Nov. 1, 1959 agreement (Exhibit 15) *did not effect an immediately-effective "transfer"* of the security and offset rights set forth in the instrument.

FACTS SUPPORTING APPELLANTS' APPEAL.

The relevant facts supporting the case of Appellants and compelling the conclusion that the security rights granted to Kent-Reese Enterprises, Inc. (herein called "Kent-Reese") constituted an immediately-effective "transfer" under the Act are the following:

(a) The three-way agreement was *made on Nov. 1, 1959* when Big Boy Markets, Inc. (herein called "Big Boy Markets"), was solvent and in full operation of its several super markets. (Tr. p. 2, line 25 through p. 3, line 11).

(b) *As of Nov. 1, 1959* the individual Appellants relinquished their right to the immediate cash repayment of their $30,700 (Tr. p. 8a, line 4, Item 6 of the Findings through p. 9, Item 8) for the purpose of benefitting Big Boy Markets, then solvent, helping that corporation's operating capital position by accepting the guarantee of Kent-Reese rather than demanding their cash (Tr. p. 9, lines 30-32, Item 8 of Findings).

(c) *As of Nov. 1, 1959* Appellant Kent-Reese incurred an immediately effective contractual obligation to the individual Appellants by its *unconditional guarantee* (Tr. p. 9, lines 8-10 and 30-32). It then agreed:

> ". . . KENT-REESE ENTERPRISES, INC., hereby guarantees to RAYMOND DOUGLASS and/or JOAN DOUGLASS and/or ROBERT REESE the payment in full by BIG BOY MARKETS, INC., of the sums set forth above" (i.e., said $30,700.)

(d) *As of Nov. 1, 1959* the then-solvent Big Boy Markets, in consideration of said unconditional guarantee, unconditionally agreed:

> ". . . to hold KENT-REESE ENTERPRISES, INC., free and harmless from any loss or liability under the above agreement and as security

> therefor does hereby grant to KENT-REESE ENTERPRISES, INC., the right to a credit upon its PROMISSORY NOTE obligation. . . ."

and made the other express and immediately-effective contractual arrangements set forth in said instrument (Tr. p. 9, lines 11-16).

(e) Big Boy Markets continued in business for eleven months nineteen days after this agreement until Oct. 19, 1960 when Big Boy Markets filed its petition in bankruptcy and was adjudicated a bankrupt (Tr. p. 8, lines 2-6).

(f) Appellant Kent-Reese, after the bankruptcy of Big Boy Markets, met its guarantee obligations to the individual Appellants by payment of the sums guaranteed and it offset this amount against the balance of $31,000 then remaining unpaid on its $54,000 promissory note obligation to Big Boy Markets (Tr. p. 10, line 19 through p. 11, line 1, Items 11 and 12 of Findings).

Because the trial court decided that the actions and facts did not result in a transfer effective as of Nov. 1, 1959, the court applied the ruinous (to Appellants) legal fiction and implication that "such transfer is deemed by law to have been made immediately before the filing of the petition in bankruptcy" (Tr. p. 11, lines 31 and 32). From this fictional, implied time of transfer followed the conclusions of law numbered 3, 4, 6 and 9 (Tr. pp. 12 and 13) which result in the technical conclusions of law and judgment that Appellants were guilty of a transfer as of Oct. 19, 1960

which made them guilty of a fraud and subject to the trial court's inescapable and damning judgment.

The injustice resulting from this error of the trial court in applying the law to the facts is obvious:

(1) The individual Appellants who relinquish their rights to the return of $30,700 on Nov. 1, 1959 acting in good faith and for the benefit of Big Boy Markets, and

(2) Appellant Kent-Reese, the corporation which made it possible for the Bankrupt to retain the use of this $30,700 as part of its operating funds in reliance upon the security granted to it by Big Boy Markets (i.e., through the right of offset against money owing by it to the Bankrupt)

are by the trial court's decision stigmatized as having worked a fraud upon the corporation they helped.

The injustice is, further, that although the combined arrangement and concessions of the Appellants resulted in Big Boy Markets enjoying and having the benefits of Appellants' $30,700 as additional cash operating funds from Nov. 1, 1959 forward, by the error of the trial court's decision the Appellants and particularly Kent-Reese would be denied the security upon which they relied before acting to their detriment to accommodate and benefit Big Boy Markets.

We call the appellate court's attention to the fact that these sums supplied by the individual Appellant and guaranteed and paid to them by Kent-Reese are all "hard dollars". There has been no claim by Appellants of any interest or any other compensation

for the Bankrupt's use of said $30,700 from 1958 and 1959 (Tr. p. 8a, lines 4-11 and p. 10, lines 24-32; Items 6 and 12 of Findings).

There should possibly be some greater differentiation between the different legal situations or positions of the Appellants:

(A) Individual Appellants Douglass and Reese received nothing directly from the Bankrupt. They proceeded to seek the recovery of their $30,700 upon the unconditional guarantee by Kent-Reese by their claim for payment against Kent-Reese. They received their money only from Kent-Reese on the basis of that guarantee—*they received nothing from the Bankrupt* (Tr. p. 10, lines 24-32).

(B) Kent-Reese prior to the bankruptcy reduced its $54,000 promissory note balance payable to Big Boy Markets until it equaled the approximate balance which it had guaranteed to the individual Appellants, Douglass and Reese (Tr. p. 10, lines 14-23). At the time of bankruptcy, *Kent-Reese then refused to pay the remaining loan balance (which constituted its security for its unconditional guarantee)* basing its right of offset upon the Nov. 1, 1959 contract which it claims was fully effective and operative as of that date (Tr. p. 10, line 24 through p. 11, line 5 and Appellants' Opening Brief).

OPPOSITION ARGUMENTS OF REPLY BRIEF.

In the Reply Brief the rebuttal of our authorities, ideas and arguments rest only upon the narrow issue and contention (see p. 6 of Reply Brief) that the trial court's decision was correct to the effect that the Nov. 1, 1959 transaction did not then effect a present transfer of security rights under the definitions sections 30 and 60a(2) of the Act *because*:

(a) The Nov. 1, 1959 security agreement "was never perfected as required by State law", and

(b) Unless the transfer was ". . . so perfected against such liens . . .", that is, against liens or rights of other creditors of bona fide purchasers, then ". . . it shall be deemed to have been made immediately before the filing of the petition."

We shall address this Closing Brief, therefore, to refuting of Appellee's citations and arguments made in his efforts to support these contentions.

GUARANTY AND SECURITY-OFFSET AGREEMENT AND RIGHTS THEREUNDER WERE PERFECTED WHEN EXECUTED ON NOV. 1, 1959.

Replying to Appellee's contentions (pp. 4 through 13 of Reply Brief) by reference to those same letters and subjects, Appellants respectfully present their closing arguments, etc., as follows.

(A) Transfer Was Perfected When Contract Was Executed.

The *Aulick v. Largent* (1961) 295 Fed. 2d 41 case cited by Appellee relates to a situation involving a transfer actually contracted for and made within four

months of filing of the bankruptcy petition and made at a time when the bankrupt was actually already insolvent.

This case is therefore irrelevant to the case at bar where Big Boy Markets was in the full swing of operating its supermarkets and was solvent when it made the Nov. 1, 1959 agreement which is under examination here, that is, where it made the security-offset agreement eleven months and nineteen days prior to the bankruptcy petition filed Oct. 19, 1960.

Appellee cites *In re Quaker City Sheet Metal Co.* (1942) 129 Fed. 2d 894 and *In re Kaufmann* (1956) 142 Fed. Sup. 759 as authority for the proposition that the security rights of Appellants were not perfected because other parties could have acquired rights superior to those of Kent-Reese as against its rights of offset under the Nov. 1, 1959 contract.

Neither of these cases appears to be in point.

There appears to be no question but that *the guaranty which Kent-Reese made to the individual Appellants* Douglass and Reese was *absolute, unconditional and fully effective on Nov. 1, 1959. That is not an issue* in this case but illustrates the immediate effectiveness which the parties intended for the agreement.

We are, therefore, analyzing *only the question as to whether or not the security-offset aspects of the Nov. 1, 1959 agreement created, as between Kent-Reese and Big Boy Markets, an immediate lien and offset and security* rights in favor of Kent-Reese which became fixed, enforceable and perfected rights as of that date.

In the *Quaker City Sheet Metal* case the creditors whose secured-claim status was being questioned were creditors who had made loans to the Bankrupt *within four months prior to filing of bankruptcy* and who, *within* that four-months critical time took an assignment of contracts and of accounts receivable arising from those contracts as collateral security for these loans. *But they did not give notice* of those assignments to the persons owing the accounts receivable so assigned as required by state law.

In this case the appellate court reversed the trial court (which had found the assignment to the bank to be entitled to preference as a secured creditor) and found, instead, that because these creditors had not given notices of the assignment to the debtors of the accounts assigned they had not perfected the assignments under Pennsylvania law. The majority decision in this case (there was a strong dissenting opinion) at page 896 shows that this decision rested upon (a) the fact that the assignments were executed within four months of bankruptcy and (b) the fact that no notices of the assignments were given. This case is therefore irrelevant as authority for the case at bar. In statements revealing the reasoning of the court, the majority opinion stated:

> "There remains for consideration the question whether under the law of Pennsylvania subsequent bona fide assignees or attaching creditors of the company could have acquired rights to the accounts receivable here in question superior to the rights of the bank and Dearden under their prior assignments in view of the fact that the

> latter gave no notice of their assignments to the persons owing the accounts.
>
> "The trustee urges that under the law of Pennsylvania a subsequent bona fide purchaser of the accounts receivable from the company could have acquired rights to the accounts superior to those of the bank and Dearden provided only that he gave notice before they did. In support of this proposition the case of In re Phillips' Estate (No. 3), 1903, 205 Pa. 515, 55 A. 213, 66 L.R.A. 760, 97 Am.St.Rep. 746, is cited. That case involved a contest between successive assignees of a fund in the hands of a third person. The court found in favor of the subsequent assignee, adopting the rule that (205 Pa. at page 524, 55 A. at page 216) 'if an assignee fails to give notice to the person holding the fund assigned to him, a subsequent assignee, without notice of the former assignment, will, upon giving notice of his assignment, acquire priority'."

The *Kaufmann* case in Kentucky involved an unrecorded conditional sales contract where the security to the (preferred) creditor was perfected under Kentucky law only five days prior to the adjudication in bankruptcy.

In relevant parts of this decision the federal court said (at page 760) on the relevant issues which distinguish this case from the case at bar:

> "However, in 1950 Congress amended Section 60 of the Bankruptcy Act and it now provides that the recognition of equitable liens would be denied where available means of perfecting a legal lien have not been employed. Section 60, sub.a(6) of

> the Bankruptcy Act, 11 U.S.C.A., § 96, sub.a(6), Republic National Bank of Dallas v. Vial, 5 Cir., 1956, 232 F. 2d 785.
>
> "[1-4] In Kentucky a conditional sales contract must be recorded to be perfected as against subsequent lien creditors, KRS 382.270."

Under California law there are no requirements of recordation relative to the transfers of promissory notes whether they be non-negotiable or negotiable. None of Appellee's cited cases related to promissory notes. They related to accounts receivable and conditional sales contracts in states having special laws relative to the prerequisites of perfecting such transfers.

In the case at bar there were both notice and possession in the pledgee of the promissory note insofar as the officers of both corporations which were signatories to the promissory note and, later, to the security-offset agreement were the same persons and both of these corporations had the same president (Appellant Douglass was president and a director of both corporations) and Appellant Reese was an officer (secretary-treasurer of Big Boy Markets and vice president of Kent-Reese and a director of both corporations) and between them said officers owned seventy-five (75%) percent of the stock of both corporations and participated in these transactions (Tr. p. 8, lines 11-24; Items 3 and 4 of Findings).

Appellee next cites *Walters v. Bank of America* (1937) 9 Cal. 2d 46, 69 Pac. 2d 839 for the proposition that the offset rights of Kent-Reese could not be

invoked to defeat a garnishment and *quoting an incomplete portion* of the case report misleadingly.

The facts of this case were that a garnishment was levied against a bank account of the debtor. The debtor owed money to defendant Bank of America and the bank, therefore, had a right of offset. Had it exercised that right of offset, no lawsuit would have been justified. Instead, however, *defendant bank did not offset* the funds in its control against the debtor's obligations to the bank after notice of garnishment but allowed the debtor to have the full benefit of its deposited money to satisfy drafts and obligations to other persons.

The alleged quotation "cited" or "quoted" by Appellee at page 7 of Appellee's Reply Brief nowhere appears on that page and the omission on the second line of the "quotation" printed in Appellee's Reply Brief entirely changes the sense. On page 57 of this California Supreme Court Report the actual and exact quotations of the first two paragraphs are as follows, the second being the exact quotation nearest that printed in Appellee's Reply Brief and indicating by asterisks the omission therefrom which changes the meaning of the portion "quoted" in said Reply Brief:

> "The case of Prudential Loan & Trust Co. v. Metzler, supra, likewise involved the right of set-off of a garnishee bank of a debt due from its depositor. We find the following stated: 'The bank had the right to apply the funds in its hands at the time of the garnishment, belonging to Metzler, to the payment of a debt due from the latter to it . . . But it had no right to pay such funds to

the order of Metzler during the garnishment proceedings and such payment was at the risk of the Bank . . . As between the attaching creditor and the judgment debtor the garnishee should occupy a disinterested position, and hold the money or property garnished until the matter is adjudicated or the attachment is discharged. (Citing authorities.) The bank waived the privilege of applying the funds upon Metzler's notes by paying him the same during the pendency of the garnishment proceedings. By so doing it clearly indicated that there was no intention on its part to do so. . . .'

> "To allow the garnishee to claim his right of set-off to defeat the claim of the creditor, * * * and then to permit him to pay the fund in controversy to the defendant * * *, would result in an unwarranted interference with the rights of other creditors of the defendant. (Trottier v. Foley, supra.)"

At page 56 of this case the California Supreme Court cited with approval the Illinois Appellate Court case of *Obergfell v. Booth,* 218 Ill. App. 492 and said:

> "The court stated: 'While the garnishee, under the provisions of the statute, has the right, upon being notified of garnishment proceedings, to adjust any demands it may have against the judgment debtor, it cannot enter into any new agreements with the debtor involving money or property which it holds to secure the debt, which agreements may operate to the detriment of the attaching creditor . . . Inasmuch as the garnishee chose to enter into this new arrangement with the judgment debtor, after it had been served with

> process in this case and had filed its answer as above set forth and had thus postponed its use or right to use the collateral [deposit] in bringing about the payment of the indebtedness, and continued to hold such collateral, we are of the opinion that the trial court did not err in entering judgment against the garnishee for the amount of the deposit.' In other words, inasmuch as the amount of the deposit was not actually applied in payment of the debt, but was continued to be held by the bank as the property and for the benefit of the debtor, it must be considered to have been held likewise for the benefit of the attaching creditor."

This case also is then inapplicable to the case at bar because in that case the bank had not offset the security lien which it had against the funds it owed to the garnisheed debtor but had released the funds to or for the benefit of the debtor, waiving its security lien and right of offset. *In the case at bar, however, Appellant Kent-Reese did offset* against the money which it owed to Big Boy Markets in exact compliance with the provisions of the Nov. 1, 1959 contract granting it the security of the right of offset, etc.

This right of offset as a legally enforceable and proper right was later referred to with approval in the case of *Hauger v. Gates* (1954) 42 Cal. 2d 752, 269 Pac. 2d 609 in a general discussion of that subject citing the *Walters* case.

Next Appellee cites *Hecht v. Smith* (1960) 183 Cal. App. 2d 723, 7 Cal. Rptr. 209, on a case having to do

with a negotiable promissory note. This case does not support Appellee's contention, primarily because the case at bar does not concern a negotiable promissory note but, rather, a non-negotiable promissory note.

The trial court did not find the subject promissory note to be a negotiable instrument. Counsel for Appellants will endeavor to augment the record by a copy of the promissory note of May 1, 1959 (Exhibit 11) and a copy of Appellants' "CLOSING POST-TRIAL MEMORANDUM", which deals at length specifically with this question.

In the *Hecht* case the question before the court was whether or not to dissolve an attachment which was levied against a negotiable promissory note owned by defendant which was in the possession of a third party (which promissory note happened to be a promissory note by the plaintiffs to defendant, which did not alter the situation or decision). There was no claim by the defendant or the third party holding the negotiable promissory note as to any rights of offset or security. This case also therefore fails to be relevant to the issue in the case at bar.

(B) Date of Surety Agreement Controls Effective Date of Transfer.

Under this part of the Reply Brief, Appellee cites *Davis v. Woolf* (1945) 147 Fed. 2d 629. However, this is a case which turned upon the fact that the corporation involved was found to have been insolvent at the time of the transfer.

The law is not disputed by Appellants that such a transfer would be a preference in fraud of creditors if made at a time when the corporation was insolvent and within four months of the date of filing in bankruptcy; however, *that was not the situation in the case at bar.*

Appellants' Opening Brief sets forth the applicable law requiring a corrected finding that the security-offset contract of Nov. 1, 1959 between Kent-Reese and Big Boy Markets was effective as of its date of execution as a "transfer" under the Act, a "transfer" effective, operative and fully enforceable as of that date.

(C) The Nov. 1, 1959 Transfer Was Not Voidable Under California Law.

Appellee cites and relies upon the provisions of California Civil Code § 3440 to claim that the contractual creation of a right of offset and the creation of the security to Kent-Reese by contract on Nov. 1, 1959, were in violation of this statute.

Section 3440 is one of the major sections under the Uniform Fraudulent Conveyance Act. This act could conceivably cover this situation if it were not for the express exception not cited by Appellee in its quotation from Section 3440. Section 3439.01 defines a "conveyance" under this act as including such an assignment, pledge, creation of a lien or encumbrance on tangible or intangible property, but provides, in its parts essential for this analysis:

> "Every transfer of personal property and every lien on personal property made by a person hav-

> ing at the time the possession or control of the property, and not accompanied by an immediate delivery followed by an actual and continued change of possession . . . is conclusively presumed fraudulent and void as against the transferer's creditors . . . as against purchasers or encumbrancers in good faith subsequent to the transfer".

As the very first exception the following paragraph reads:

> "This section shall not apply to any of the following: (a) Things in action . . ."

First: Appellee's case and findings are devoid of any proof or finding that any of the creditors represented by the Appellee were "purchasers or encumbrancers in good faith subsequent to the transfer."

Second: The exception of "things in action" exempts from the operation of this "fraudulent conveyances" statute such things as promissory notes and similar choses in action (a synonym for "things in action"). This act is intended principally to cover commercial transactions relating to tangible goods and merchandise and for this reason "things in action" are specifically exempted from its provisions.

California Civil Code § 953 defines a "thing in action" and states: "a thing in action is a right to recover money or other personal property by a judicial procedure."

In the case of *Marroquin v. Barrial* (1959) 174 Cal. App. 2d 540, 345 Pac. 2d 30 it *was held that a transfer*

of a promissory note and of the deed of trust securing the same *even where the debtor retained both the promissory note and the trust deed* (without recording an assignment of the note and/or trust deed) *was not a fraudulent transfer* as against a creditor seeking to garnishee the same.

California cases have found "things in action" to include the following classes of property similar to promissory notes:

(a) An open, current and mutual account. See *Pedley v. Doyle* (1918) 177 Cal. 284, 170 Pac. 602;

(b) A contract of guaranty. See *Reios v. Mardis* (1912) 18 Cal. App. 276, 122 Pac. 1091;

(c) Bank savings pass book. See *In re Douglas Estate* (1961) 197 Cal. App. 2d 258; 17 Cal. Rptr. 89;

(d) (Appellee's discussion relative to mortgages.)

Appellants make no contention that this Nov. 1, 1959 security-offset contract created any mortgage and no discussion of this subject appears to be necessary therefore.

CONCLUSION

If the analysis of the facts and law as set forth in Appellants' Opening Brief is correct, as we believe it to be, and if the decision of the trial court on the critical issue of the effective date of the "transfer" is in error as we believe the facts and the law discussed in this Closing Brief further affirmatively prove (without relying for this conclusion upon the deficiencies of the irrelevant citations of the Reply Brief) we respectfully submit that the decision of the trial court must be reversed to make the decision accord with the facts of the case and the applicable California and Bankruptcy Act laws and to prevent a grievous injustice in both stigmatizing the Appellants with the unmerited charge of commercial fraud and the ruinous burden of a monetary judgment unmerited by their conduct in endeavoring to assist Big Boy Markets at a time when it was solvent and when the assistance of the Appellants benefitted it and gave it increased cash operating funds at the expense of valuable consideration and concession by both of them.

Dated, Oakland, California,
January 12, 1967.

Respectfully submitted,
C. Wadsworth White,
Attorney for Appellants.

No. 20663

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

COMMISSIONER OF INTERNAL REVENUE,

Petitioner

v.

OSCAR E. BAAN and EVELYN K. BAAN,

Respondents

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

RICHARD C. PUGH,
Acting Assistant Attorney General.

LEE A. JACKSON,
GILBERT E. ANDREWS,
MARTIN T. GOLDBLUM,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

I N D E X

Page

Opinion Below-- 1
Jurisdiction--- 1
Question Presented--- 2
Statutes and Regulations Involved-------------------------------- 3
Statement-- 3
Specification of Errors Relied Upon------------------------------ 7
Summary of Argument-- 8
Argument:

The Tax Court erred in holding that the transaction whereby Pacific sold its interest in its telephone business in three northwestern states to its shareholders constituted a non-taxable distribution within the purview of Section 355 of the 1954 Code---------------------------- 13

A. Absent any statutory exemption, the distribution of rights by a corporation may be taxed as dividend income to its shareholders upon their exercise-------------------- 14

B. The purpose and legislative history of Section 355--- 16

C. Pacific did not "distribute" Northwest stock to taxpayers "with respect to its stock" as required by Section 355(a)(1)(A)----------- 19

D. Pacific did not distribute with respect to its stock control of Northwest as required by Section 355(a)(1)(D)---------------------------- 23

E. Pacific did not distribute control of Northwest in a single distribution as required by Section 355(a)(1)(D)-- 25

F. Northwest acquired telephone businesses from Pacific in a transaction in which gain was "recognized" within the purview of Section 355(b)(2)(C)-- 27

Conclusion--- 30
Appendix A--- 32
Appendix B--- 41

Page

CITATIONS

Cases:

Ammann, Jack, Photogrammetric Engineers, Inc. v. Commissioner, 341 F. 2d 446---------------------------- 26
Baan v. Commissioner, 45 T.C. 51------------------------- 1
Choate v. Commissioner, 129 F. 2d 684-------------------- 15, 16
Commissioner v. Chase Manhattan Bank, 259 F. 2d 231------ 26
Commissioner v. LoBue, 351 U.S. 243---------------------- 16
Cortland Specialty Co. v. Commissioner, 60 F. 2d 937----- 28
Duparquet Co. v. Evans, 297 U.S. 216--------------------- 19
Gibson v. Commissioner, 133 F. 2d 308-------------------- 15
Gregory v. Helvering, 293 U.S. 465----------------------- 17
Helvering v. Northwest Steel Mills, 311 U.S. 46---------- 19
Helvering v. Southwest Corp., 315 U.S. 194--------------- 20, 26
Lloyd-Smith v. Commissioner, 116 F. 2d 642--------------- 28
Palmer v. Commissioner, 302 U.S. 63---------------------- 15
Smith Engineering Co. v. Rice, 102 F. 2d 492------------- 26
Timberlake v. Commissioner, 132 F. 2d 259---------------- 15
Turnbow v. Commissioner, 368 U.S. 337-------------------- 14

Statutes:

Internal Revenue Code of 1939, Sec. 112 (26 U.S.C. 1952 ed., Sec. 112)--------------------- 18

Internal Revenue Code of 1954:

Sec. 301 (26 U.S.C. 1964 ed., Sec. 301)------------- 32
Sec. 305 (26 U.S.C. 1964 ed., Sec. 305)------------- 21
Sec. 307 (26 U.S.C. 1964 ed., Sec. 307)------------- 21
Sec. 311 (26 U.S.C. 1964 ed., Sec. 311)------------- 33
Sec. 312 (26 U.S.C. 1964 ed., Sec. 312)------------- 21
Sec. 316 (26 U.S.C. 1964 ed., Sec. 316)------------- 21
Sec. 351 (26 U.S.C. 1964 ed., Sec. 351)------------- 33
Sec. 355 (26 U.S.C. 1964 ed., Sec. 355)------------- 34
Sec. 356 (26 U.S.C. 1964 ed., Sec. 356)------------- 37
Sec. 361 (26 U.S.C. 1964 ed., Sec. 361)------------- 38
Sec. 368 (26 U.S.C. 1964 ed., Sec. 368)------------- 39
Sec. 1001 (26 U.S.C. 1964 ed., Sec. 1001)----------- 39
Sec. 1002 (26 U.S.C. 1964 ed., Sec. 1002)----------- 39

Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 203------ 16
Revenue Act of 1934, c. 277, 48 Stat. 680---------------- 17
Revenue Act of 1951, c. 521, 65 Stat. 452---------------- 17

Page

Miscellaneous:

Bittker, Federal Income Taxation of Corporations and Shareholders (Student ed., 1963), pp. 322, 338----- 21, 25
S. Rep. No. 781, 82d Cong., 1st Sess., p. 57 (1951-2 Cum. Bull. 458, 499)------------------------ 13
S. Rep. No. 1622, 83d Cong., 2d Sess., p. 274 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4912-4913)-- 18
Treasury Regulations on Income Tax (1954 Code):
Sec. 1.301-1 (26 C.F.R., Sec. 1.301-1)------------- 15
Sec. 1.355-1 (26 C.F.R., Sec. 1.355-1)------------- 39
Sec. 1.355-2 (26 C.F.R., Sec. 1.355-2)------------- 40

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 20863

COMMISSIONER OF INTERNAL REVENUE,

Petitioner

v.

OSCAR E. BAAN and EVELYN K. BAAN,

Respondents

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

OPINION BELOW

The findings of fact and opinion of the Tax Court (I-R. 79-127) [1/] are reported at 45 T.C. 51.

JURISDICTION

The petition for review (I-R. 129-131) involves income taxes for the taxable year 1961. On February 11, 1963, the Commissioner of Internal Revenue mailed to taxpayers notice of a deficiency, asserting a deficiency in those taxes of $284.44. (I-R. 18-21.) Within ninety days thereafter, on or about March 5 or March 7, 1963, taxpayers filed a petition with the

---

1/ "I-R." references are to Volume one of the record on appeal.

Tax Court for a redetermination of that deficiency under the provisions of Section 6213 of the Internal Revenue Code of 1954. (I-R. 1, 4-17.) The decision of the Tax Court was entered on October 20, 1965. (I-R. 3, 128.) The case is brought to this Court by a petition for review filed January 13, 1966 (I-R. 129-131), within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. Jurisdiction is conferred on this Court by Section 7482 of that Code.

QUESTION PRESENTED

Pacific transferred assets used in the conduct of telephone business in three northwestern states to a new corporation (Northwest) in exchange for the latter's stock and a $200,000,000 demand note. In 1961, Pacific distributed to its shareholders rights (represented by transferable stock purchase warrants) to purchase 57% of the Northwest stock at a price of $16 per share. The Northwest stock purchased by taxpayers, shareholders of Pacific, had a fair market value of $26 per share on the date of purchase. The stock rights had been issued by Pacific on the basis of one right for each share of Pacific stock held, with a total of six rights (plus payment of $16) necessary to purchase one share of Northwest stock.

The question presented is:

Whether the Tax Court erred in rejecting the Commissioner's determination that the difference between the purchase price ($16) and the fair market value of the Northwest stock ($26) constituted a taxable dividend to taxpayers rather than a nontaxable distribution under Section 355 of the Internal Revenue Code of 1954.

STATUTES AND REGULATIONS INVOLVED

The relevant provisions of the Internal Revenue Code of 1954 and the Treasury Regulations are set forth in Appendix A, infra.

STATEMENT

During 1961, taxpayers Oscar E. Baan and his wife, Evelyn K. Baan, owned 600 shares of the common stock of Pacific Telephone and Telegraph Company (Pacific). (I-R. 81.) In that year, taxpayers received 600 stock rights, represented by transferable stock purchase warrants issued by Pacific, entitling them to purchase one share of the common stock of Pacific Northwest Bell Telephone Company (Northwest) for $16 and six stock rights. On October 11, 1961, taxpayers exercised those stock rights and, in consideration for $1,600, received 256 shares of Northwest stock. The fair market value of Northwest common on October 5, 1961, was $26 per share. (I-R. 99, 100.) The Commissioner determined that the difference between the fair market value of the Northwest stock received and the $16 per share paid constituted a taxable dividend. Taxpayers contended that the profit realized on the exercise of their stock rights was not subject to tax. Resolution of that question turns on whether and to what extent Section 355 of the Internal Revenue Code of 1954 applies to the transaction between Pacific and Northwest and the subsequent distribution of stock rights by Pacific.[2/]

2/ The instant case was consolidated for trial with the case of Irving and Margaret Gordon. The Gordons are residents of New York and a petition for review with respect to their tax liability has been filed with the Court of Appeals for the Second Circuit.

The facts surrounding the transaction between Pacific and Northwest and the subsequent distribution by Pacific of stock rights through warrants are not in dispute. The detailed findings of the Tax Court are based for the most part upon stipulated facts. The facts material to the issues on review may be summarized briefly as follows:

Prior to July 1, 1961, Pacific, a California corporation furnished communication services, mainly local and long-distance telephone services, in California, Oregon, Washington and Idaho. Beginning in 1960, the California and non-California businesses of Pacific were operated in separate divisions. For multiple business reasons, the management and shareholders of Pacific decided early in 1961 that the non-California businesses should be handled by a separate corporation. Accordingly, on March 27, 1961, Pacific caused the organization of Northwest, a Washington corporation, receiving 10,000 shares of common stock for $110,000 in cash. (I-R. 81, 87-89, 94.)

As of June 30, 1961, all of the business and properties of Pacific in Oregon, Washington and Idaho were transferred to Northwest in exchange for (1) the issuance to Pacific by Northwest of 30,450,000 shares of common stock, (2) an interest-bearing demand note in the amount of $200,000,000, and (3) assumption by Northwest of certain liabilities of Pacific. At the close of business on June 30, 1961, Pacific ceased all operations in Oregon, Washington and Idaho, and Northwest commenced operations on July 1, 1961. (I-R. 95-96.)

An integral part of the original plan for dividing the businesses of Pacific was the sale of Northwest stock to the shareholders of Pacific. Rights were to be issued to the shareholders of Pacific which would

enable them to purchase stock in Northwest at a price to be set by Pacific's board of directors. The purpose of the sale was to provide Pacific with funds for its future operations in California. (I-R. 92.)

On August 25, 1961, Pacific's board of directors decided that the offering price of Northwest stock to the shareholders of Pacific should be $16 per share. Pacific shareholders were to receive one transferable stock purchase warrant for each share of Pacific held, with six rights plus the payment of $16 required to obtain one share of Northwest stock. Between the time of the issuance of the rights (September 20, 1961) and the deadline for their exercise (October 20, 1961), the fair market value of Northwest stock was no less than $26 per share. (I-R. 100, 101-102.)

The Northwest stock disposed of by Pacific in the above-described 1961 offering amounted to approximately 57% of the total number of Northwest shares held by Pacific. It had been planned by Pacific from the outset that the remainder would be held for disposition at a later time. The remaining 43% of Northwest common held by Pacific was offered to Pacific's shareholders on June 12, 1963, at the same price ($16 per share), the principal difference being that eight stock rights (instead of six) were required. (I-R. 98, 104-105.)

As a result of the 1961 offering, the minority shareholders of Pacific (or their assignees) acquired 1,897,891 shares of Northwest common stock. The bulk of the total of 17,446,031 shares of Northwest sold by Pacific in 1961 was acquired by American Telephone & Telegraph Company (American) which owned approximately 90% of the common stock of Pacific. American acquired 15,548,140 shares of Northwest common.

Pacific, for its part, received for the stock sold in 1961 cash in the total amount of $279,136,496. (I-R. 85, 101.)

As of December 31, 1960, Pacific had unappropriated earned surplus in the amount of $192,053.880.76. As of December 31, 1961, Pacific had $176,935,190.15 of unappropriated earned surplus. There was a sufficient dollar amount of earnings and profits of Pacific in 1961 from which a 1961 dividend could have been paid by Pacific to its shareholders to cover the dollar amounts which the Commissioner contended in this case were received by taxpayers and other shareholders as dividend income. (I-R. 84.)

Subsequently, on June 12, 1963, still pursuant to the original plan for dividing the businesses of Pacific, the remaining 43% of Northwest common was offered to its shareholders on the basis of eight rights and payment of $16 for one share of Northwest. As a result of the 1963 offering, the minority shareholders of Pacific (or their assignees) acquired 1,416,552 shares of Northwest while American acquired 11,580,456 shares. (I-R. 104-105.)

On the consolidated income tax return filed by American and its subsidiaries for the year 1961 (which return included Pacific) no gain or loss was reported on the transaction in which Pacific transferred its non-California assets to Northwest. Similarly, no gain was reported on the consolidated return (eliminating inter-company profit) on the sale of 15,548,140 shares of Northwest common by Pacific to American. Gain was reported by Pacific, however, in the amount of $8,739,362.07, in respect to the 1,897,891 shares of Northwest sold to the minority shareholders of Pacific (or their assignees) in 1961. (I-R. 98, 101.)

In response to requests by Pacific, the Commissioner of Internal Revenue had issued a ruling letter on June 28, 1961, regarding the tax consequences of the planned division of Pacific and the distribution of Northwest stock to the shareholders of Pacific through an issue of rights. Essentially, the Commissioner ruled that, in the case of Pacific shareholders who sold their rights, the full amount realized would be ordinary income to them, and that, in the case of individual Pacific shareholders exercising their rights, the difference between the fair market value of Northwest stock (on the date the rights were exercised) and the $16 per share price paid would be taxed to such shareholders as dividend income. (I-R. 106-107.)

On these facts, the Tax Court decided that the transaction whereby Pacific sold its non-California businesses to Northwest and then sold the Northwest stock to its own shareholders (or their assignees) qualified as a tax-free spin-off within the terms and intendment of Section 355 of the 1954 Code and that taxpayers Oscar and Evelyn Baan consequently were not taxable on the gain realized by them when they exercised their rights to acquire Northwest stock having a fair market value of $26 per share at a cost to them of only $16 per share. (I-R. 110-125.) From this holding the instant petition has been filed and prosecuted.

SPECIFICATION OF ERRORS RELIED UPON

The Tax Court erred:

1. In failing to hold that the taxpayers realized dividend income to the extent of the difference between the price which they paid for the Northwest stock, and the fair market value

2. In failing to hold that taxpayers were not entitled to nonrecognition treatment because the transaction in issue did not comply with the terms of Section 355(a)(1)(A), (C) and (D).

SUMMARY OF ARGUMENT

Pacific, in 1961, transferred operating assets used in the conduct of its telephone business in three states to a newly formed subsidiary, Northwest, in exchange for all of Northwest's single-class of stock (common) and a $200,000,000 demand note. In the same year, Pacific distributed rights, represented by stock purchase warrants, to its shareholders entitling them to purchase 57% of the Northwest stock at $16 per share. When the rights were distributed and at the time they were exercised, the fair market value of the Northwest stock ($26) exceeded its purchase price under the rights. In these circumstances, it is settled that taxpayers, who are the shareholders of Pacific, realized a profit on the distribution of the rights which is taxable as a dividend, absent a specific statutory exemption. The Tax Court held that Section 355 of the Internal Revenue Code of 1954 accords tax-free treatment to the transaction and entered a decision in favor of taxpayers. The Commissioner's position is that no less than four objective requirements established by Section 355 have remained unsatisfied in this case. If this Court should decide that there was not full compliance with any one of those requirements, the decision of the Tax Court must be reversed.

1. What occurred in this case simulated a transaction commonly known as a "spin-off". A spin-off occurs when a parent corporation transfers a business to another corporation in exchange for the

latter's stock and then distributes the stock of the subsidiary to its own shareholders. Congress, having provided for tax-free distributions and exchanges incident to corporate reorganizations, similarly has provided (in Section 355) a way for the shareholders of the parent corporation to receive the stock of the subsidiary without recognition of gain or loss. The justification for that treatment rests upon the fact that the spin-off, although it involves an otherwise taxable distribution, is not an appropriate occasion for taxing shareholders' gain. The shareholders have retained their business in corporate solution, i.e., the same people have maintained their investment in the same group of businesses -- only the form of doing business has been changed. Nevertheless, Congress had for many years (1934-1951) withheld tax-free status from the spin-off because of its potential for use as a means of distributing corporate earnings and profits at capital gain rates. This wariness on the part of Congress is reflected in the structure and the terms of Section 355. By setting up four cumulative and detailed sets of conditions to nonrecognition treatment, the legislature plainly evidenced an intention that every spin-off for which tax benefits are claimed shall comply with the terms of each condition and that a relaxed "close enough will do" interpretation is not to be applied.

2. Section 355(a)(1)(A) required Pacific to distribute "with respect to its stock * * * solely stock or securities" of Northwest. All that Pacific distributed here with respect to its stock were saleable rights to purchase the stock of Northwest, and it is established that the rights themselves do not constitute "stock

or securities". The Northwest stock, on the other hand, was sold to anyone -- shareholder or nonshareholder -- who came forward with \$16 and six rights. Beyond the fact that the Tax Court improperly ignored the separate existence of the stock rights and viewed what transpired as if an outright distribution of Northwest stock had occurred, this sale by Pacific cannot be considered a distribution "with respect to its stock". The latter phrase is used as a term of art throughout the Code and denotes a transfer without a consideration -- never a sale for cash.

3. Section 355(a)(1)(D) required that "as a part of the distribution" -- obviously the distribution "with respect to its stock" set forth in Section 355(a)(1)(A) -- Pacific had to distribute all or a controlling amount (80%) of its stock in Northwest. This requirement points up the fallacy in the Tax Court's conclusion that no intelligible legislative purpose would be served in taxing Pacific's shareholders on a transaction in which they paid \$16 per share for Northwest stock when they could have received such stock tax-free had they paid nothing for it. The disposition of control prerequisite is in keeping with the rationale of the statute that when the same people continue to own the same businesses in different forms, recognition of gain or loss is inappropriate. Congress was willing to risk the fact that shareholders of Pacific receiving Northwest stock free might turn around and sell it, thus privately "cashing in" on the earnings and profits of Pacific. A sale transaction, however, in which Pacific shareholders were required to pay substantial cash amounts (\$16 per share) to stay in the game, clearly erects a barrier to shareholder succession and falls outside the

4. In view of the fact that Section 355(a)(1)(D) required that at least 80% of the Northwest stock be distributed by Pacific, the 57% actually disposed of in 1961 (the taxable year here involved) clearly does not meet the statutory test. Admittedly, it was planned by Pacific from the outset that the remaining 43% be disposed of (as it was) nearly two years later in 1963, and this intention was regarded by the Tax Court as sufficient to make the successive distributions a single "distribution" for the purposes of Section 355. Upon examination of other provisions of Section 355, however, it readily appears that such a telescopic construction of the word "distribution" renders the statute administratively unworkable. Both Section 355(a)(1)(A) and Section 355(a)(1)(D) required that Pacific have "control" of Northwest "immediately" <u>before</u> the distribution, while Section 355(b)(1)(A) required that both Pacific and Northwest be engaged in active businesses "immediately" <u>after</u> the distribution. Section 355(b)(2)(B) required that those businesses be conducted for at least five years ending on "<u>the</u> date of <u>the</u> distribution". (Emphasis supplied.) From all of the foregoing, it is evident that the distribution is a pivotal point in time to which multiple objective standards are keyed. Phrased differently, the physically separate distributions of Northwest stock in 1961 and 1963 cannot be treated as a single transaction, for the intervening years cannot be tortured to fit within the terms "immediately" and "the date".

5. In their combined operation, Section 355(a)(1)(C) and Section 355(b)(1)(A) bar nonrecognition of gain treatment if Northwest acquired its businesses "in a transaction in which gain

or loss was recognized in whole or in part". When Pacific transferred assets to Northwest in exchange for the latter's stock and a $200,000,000 demand note, the value of the note constituted taxable "boot" to Pacific in an otherwise tax-free exchange. This gain -- to the extent of the "boot" -- was "eliminated", however, on a consolidated income tax return filed by an affiliated group of corporations which included Pacific and Northwest. The profit on inter-company transactions concededly was properly omitted on the consolidated return, but the Tax Court erred in affording controlling effect to this reporting technicality. After all, Section 355 (b)(2)(C) speaks of "a transaction" in which gain or loss was recognized, and the character of the transaction was fixed when it occurred. What Congress was concerned with was the characterization of the acquisition transaction in the context of the provisions of Subchapter C of the Code (corporate distributions and adjustments) and it did not intend to hinge qualification for Section 355 tax benefits on the happenstance that an affiliated group of corporations subsequently decided (at the end of the taxable year) to file a consolidated income tax return.

ARGUMENT

THE TAX COURT ERRED IN HOLDING THAT THE TRANSACTION WHEREBY PACIFIC SOLD ITS INTEREST IN ITS TELEPHONE BUSINESS IN THREE NORTHWESTERN STATES TO ITS SHAREHOLDERS CONSTITUTED A NONTAXABLE DISTRIBUTION WITHIN THE PURVIEW OF SECTION 355 OF THE 1954 CODE

The basic question involved in this case is whether the profit realized by the shareholders of Pacific on the division of that corporation into two separate corporations (Pacific and Northwest) pursuant to a so-called "spin-off" transaction is excepted from the normal tax on dividends by Section 355 of the Internal Revenue Code of 1954, Appendix A, infra.3/ In tax parlance, "A spin-off occurs when a part of the assets of a corporation is transferred to a new corporation and the stock in the latter is distributed to the shareholders of the original corporation without a surrender by the shareholders of stock in the distributing corporation." S. Rep. No. 781, 82d Cong., 1st Sess., p. 57 (1951-2 Cum. Bull. 458, 499). The tax status of the spin-off, as well as the status of all other types of corporate transactions that have the potential of dividing a single corporation into two or more separate corporations is governed by a detailed and comprehensive set of limitations contained in Section 355.

In this case, for business reasons, Pacific undertook to separate its business in three northwestern states into a new corporation which was to be owned directly by the shareholders of Pacific. It is clear

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3/ Hereafter, references to sections are to those of the Internal Revenue Code of 1954, unless otherwise indicated.

that Pacific could have arranged this transaction in a manner that would have complied with all of the provisions of Section 355, that is, it could have transferred the assets to Northwest in exchange for stock and then distributed the stock of Northwest to its shareholders without demanding compensation. Indeed at one point, Pacific's managemen actually considered handling the transaction in this fashion. (I-R. 93.) However, because of certain alleged technical problems under state law and, more fundamentally, because Pacific desired to use the division of its business as a means of raising revenue for its California operations (I-R. 92, 93), it decided to carry out the transaction in the manner involved here. Instead of transferring the assets to Northwest for stock or securities alone, Pacific received in addition a $200,000,000 demand note, and instead of simply distributing the Northwest stock, Pacific distributed stock rights entitling its shareholders to purchase the stock of Northwest. Thus, Pacific sold rather than distributed the portion of its business conducted in the three northwestern states and in so doing, it engaged in a transaction that is outside both the limited purpose of Section 355 and the literal terms of that section.

A. Absent any statutory exemption, the distribution of rights by a corporation may be taxed as dividend income to its shareholders upon their exercise

A shareholder's receipt of property distributed by a corporation with respect to its stock is, of course, ordinarily a fully taxable event on which the entire gain must be recognized (Section 301, Appendix infra) and any claim for nonrecognition must be based upon a specific statutory exception. Turnbow v. Commissioner, 368 U.S. 337, 339-340.

It is equally clear that when a corporation undertakes to sell property to its shareholders at less than its fair market value, the difference between the purchase price and fair market value is fully taxable as a dividend. Treasury Regulations on Income Tax (1954 Code), Section 1.301-1(j), and Timberlake v. Commissioner, 132 F. 2d 259 (C.A. 4th). See also, Palmer v. Commissioner, 302 U.S. 63. However, when the distribution is effected through the use of rights to purchase property of the distributing corporation (including stock of other corporations owned by the distributing corporation), the Supreme Court's decision in Palmer and a subsequent decision of the Second Circuit in Choate v. Commissioner, 129 F. 2d 684 (and cf. Gibson v. Commissioner, 133 F. 2d 308 (C.A. 2d)), add a qualification to the above rule.

In Palmer, a corporation distributed to its shareholders rights to purchase stock of another corporation owned by it. At the time the rights were distributed there was no "spread" between the fair market value of the offered stock and the purchase price of the stock as called for by the rights. However, by the time the rights were exercised the value of the offered stock exceeded the price called for by the rights. The Court held that since no "spread" existed on the date the rights were distributed there was no intention to declare a dividend and the profit ultimately realized because such a spread had developed by the date of exercise did not constitute a dividend. Thereafter, in Choate, the Second Circuit was confronted with a situation in which there was a "spread" between the value of the offered stock and the purchase price called for by the rights on the date of distribution. In harmony with Palmer, the Court held that the existence of the "spread" indicated an intention to declare

a dividend (cf. Commissioner v. LoBue, 351 U.S. 243), but since stock rights were in the nature of an option, their exercise rather than their receipt was the proper time to determine the extent of the dividend. The amount of the dividend was the lower of the "spread" on the date of issue or the "spread" on the date of exercise.

In the instant case, it is clear that Pacific purposely distributed rights which set a purchase price for the Northwest stock below the fair market value of the stock. Accordingly, the situation that existed at th time of the distribution of the rights reflected an intention to distribu corporate earnings which, absent the application of any exemption provisi of the Code, would be fully taxable as a dividend. It is equally clear under the holdings of the above cases, that while the receipt of the rights placed the shareholders in a position to realize dividend income, the extent of the dividend is not finally determined or subject to tax until the rights are exercised. Finally, the Tax Court found (I-R. 100, 110, fn. 5) that the value of the Northwest stock on the date of exercise of the rights did not exceed the value of the Northwest stock on the date of issuance of the rights, so that the limitation announced in Choate is inapplicable here. Thus, unless taxpayers can affirmatively establish that the profit resulting from the exercise of the rights to purchase Northwest stock was excepted from Section 301 by Section 355, that profit is fully subject to tax at dividend rates.

B. The purpose and legislative history of Section 355

Congress first permitted the tax-free treatment of the spin-off transaction in Section 203(c) of the Revenue Act of 1924, c. 234, 43 Stat. 253. That section classified as a "reorganization" the transfer

by a corporation of some or all of its property to a second corporation if the first corporation or its stock holders were in control (80% stock ownership) of the second corporation. It provided that no gain or loss was to be recognized by the shareholders of the first corporation if stock of the second corporation was distributed to them during the course of the reorganization. It soon became apparent, however, that if literally applied, Section 203(c) could lead to wide-spread tax avoidance. Arguably, it would have permitted the transfer of cash or other liquid assets to a new corporation whose stock could then be distributed to the shareholders of the old corporation who in turn would be in a position to liquidate the new corporation and receive the cash or liquid assets as a liquidating distribution taxable at capital gains rates. This was the very transaction involved in the landmark case of Gregory v. Helvering, 293 U.S. 465.

During the pendency of the Gregory litigation, Congress in 1934 eliminated the provision which characterized the spin-off transaction as a nontaxable reorganization (Revenue Act of 1934, c. 277, 48 Stat. 680). Thereafter, from 1934 until 1951, and irrespective of whether it served a legitimate business need or was part of a tax avoidance scheme, the spin-off transaction resulted in the shareholders being fully taxable at dividend rates to the extent that the fair market value of the stock received reflected earnings and profits of the distributing corporation.

Then, in the Revenue Act of 1951, c. 521, 65 Stat. 452, Congress was persuaded that business reasons could exist which would justify according tax-free status to the division of a single corporation into one or more corporations each of which is to be owned directly by the

shareholders. It reinstated nonrecognition treatment to certain limited spin-offs, and, as an ultimate safeguard, Congress provided that in all events, dividend treatment would be accorded the transaction even if it would otherwise qualify under the spin-off provisions if the transaction was principally used as a "device" for distributing earnings and profits. Section 112(b)(11) of the Internal Revenue Code of 1939, as added by Section 317 of the Revenue Act of 1951, c. 521, 65 Stat. 452. Thereafter, in the Internal Revenue Code of 1954, Congress sought to create a single set of limitations that would govern all forms of transactions having a divisive potential (including the so-called split-offs and split-ups as well as the spin-offs). All such transactions were to be tested under the provisions of Section 355, and that section, in addition to tightening and narrowing the basic prerequisites for nonrecognition, also carried over the "device" provision that was part of the 1954 legislation. S. Rep. No. 1622, 83d Cong., 2d Sess., p. 274 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4912-4913).

In sum, an examination of the history of Section 355 and its predecessors indicates that Congress has been much concerned over the years with whether there was a need to accord tax-free status to corporate divisions and stock distributions. This concern is clearly manifested in the provisions of Section 355 which have been carefully drafted to delineate a narrow range of transactions that are entitled to the preferred treatment accorded by that section.

The fact that Section 355 is an exemption provision would, standing alone, require that its terms be strictly construed. As the Supreme Court observed in *Helvering* v. *Northwest Steel Mills*, 311 U.S. 46, 49:

> It has been said many times that provisions granting special tax exemptions are to be strictly construed.
>
> Measured by this sound standard it is probably not necessary to go beyond the plain words of * * * [the tax statute pertinent to that case] in search of the legislative meaning.

Beyond that, however, the terms and structure of Section 355 militate against the relaxed construction adopted by the Tax Court. In the ascertainment of legislative intent, there is need to keep in view the structure of the statute, and the relation, physical and logical, between its parts. *Duparquet Co.* v. *Evans*, 297 U.S. 216, 218. The extreme length and complexity of Section 355, imposing cumulative prerequisites to the nonrecognition of gain or loss, reflect the wariness of Congress in dealing with an exemption which, long experience had shown, might be used to spring earnings and profits tax-free. Although Congress may have been persuaded that corporate divisions for business purposes should not be inhibited by the recognition of gain or loss to shareholders whose economic positions have in substance remained the same, the clear intention of Congress manifested in Section 355 is that, at a minimum, all exempted divisions would comply with every one of the prerequisites set forth in the statute.

C. Pacific did not "distribute" Northwest stock to taxpayers "with respect to its stock" as required by Section 355(a)(1)(A)

Section 355(a)(1)(A) establishes as the first of four prerequisites delineating the type of transaction which qualifies for nonrecognition that the corporation [Pacific] distribute "to a shareholder, *with respect*

to its stock * * * solely stock or securities of a corporation * * * which it controls immediately before the distribution." (Emphasis supplied.) In this case, Pacific did not "distribute" Northwest stock "with respect to its stock." Rather, it sold Northwest stock having a market value of $26 for six stock rights and $16. The only thing Pacific distributed "with respect to its stock" were stock rights, and such rights are not "stock or securities," but only options to purchase stock. Helvering v. Southwest Corp., 315 U.S. 194;[4/] Section 1.355-1(a), Treasury Regulations on Income Tax (1954 Code), Appendix A, infra. The Tax Court dismissed this deviation from the terms of Section 355 with the astonishing statement that "The stock of Northwest was literally 'distributed' to petitioners, albeit for a consideration * * *." (I-R. 1 This statement is completely unfounded. Anyone who had six rights and $16 was entitled to receive "with respect to" that consideration alone one share of Northwest stock -- it made absolutely no difference whether that individual had been a shareholder of Pacific or had purchased those rights on the open market.

It is important to note that the Tax Court attaches to the phrase "distributes to a shareholder, with respect to its stock" -- as it appear in Section 355(a)(1)(A)(i) -- a meaning foreign to its employment in other provisions of the Internal Revenue Code. Shortly stated, a distribution by a corporation with respect to its stock never means a sale

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4/ The Supreme Court plainly stated that stock purchase warrants are not voting stock. The distribution of voting stock is necessary to qualify under Section 355(a)(1)(D)(ii) which incorporates the "control" definitio in Section 368(c), Appendix A, infra.

to shareholders for a cash consideration. The sole consideration permitted by Section 355 is an exchange of stock or securities, relevant to transactions such as the split-up and split-off not in issue here.[5/] See Section 355(a)(1)(A)(ii) and (a)(2)(B).

Whatever meaning may be attached to the word "distribute" standing alone or in a different context, the phrase "distribution * * * with respect to * * * stock" is a term of art with a consistent meaning throughout the Code. It is always used to refer to distributions _without_ consideration, not sales. See Section 301 (distributions of property), Section 305 (distributions of stock and stock rights), Section 307 (basis of stock and stock rights acquired in distributions), Section 311, Appendix A, _infra_ (taxability of corporations on distribution), and Section 312 (effect of a distribution on corporate earnings and profits).[6/] For example, Section 311(a) specifically provides that a corporation shall _not_ recognize gain on a distribution ("with respect to its stock") of its stock or property. It is apparent that a distribution with respect to stock cannot encompass a sale of property, for on a sale the corporation

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5/ The split-off involves the same type of transaction as the spin-off except that the shareholders surrender part of their stock in the parent corporation in exchange for stock in the subsidiary. The parent corporation in a split-up distributes the stock of the subsidiary to one group of shareholders in exchange for all of their stock in the parent; those shareholders' interest in the parent is thus liquidated whereas they become the sole owners of the subsidiary. See Bittker, Federal Income Taxation of Corporations and Shareholders (Student ed., 1963), p. 322.

6/ Note that Section 316, which defines a dividend, is not limited to distributions with respect to stock, but includes "any distribution of property made by a corporation to its shareholders * * * out of its earnings and profits" and "every distribution is made out of earnings and profits to the extent thereof." Therefore, a dividend may include transactions other than a distribution with respect to stock, the latter term being more restrictive.

would be required to recognize gain to the extent that the purchase price exceeded the adjusted basis of the property.[7/] Sections 1001, 1002, Appendix A, infra. There is a stated exception to the general rule of Section 311 which further confirms that no money or property is to pass from the shareholder in consideration for a distribution with respect to stock. It applies where property subject to a liability is distributed to a shareholder "with respect to * * * stock" (whether or not the shareholder assumes the liability), and the amount of the liability exceeds the adjusted basis of the distributed property. In that circumstance, the statute provides that "gain shall be recognized to the distributing corporation in an amount equal to such excess as if the property distributed had been sold at the time of the distribution. Section 311(c). Although no consideration passes on such a distribution, there nonetheless may be a realization of gain by the distributing corporation that should be taken into account at that time as if a sale had occurred. The very fact that Congress found it necessary to create a special exception as to property subject to a liability establis[hes] that a distribution with respect to stock does not include a sale. Accordingly, it is reasonable, and in step with the normal rules of statutory interpretation, to conclude that the insertion in Section 355 of the term distribution "with respect to * * * stock" was intended to impose a special condition on the spin-off consistent with the meanin[g] of that critical phrase as it is used throughout the Code.

7/ Pacific reported taxable gain in the amount of $8,739,362.07 which it realized in selling Northwest stock to minority shareholders. (I-R. 101)

D. Pacific did not distribute with respect to its stock control of Northwest as required by Section 355(a)(1)(D)

As previously stated, supra, the structure of Section 355 is a uccession of cumulative requirements which must be met before a spin-ff may be afforded nonrecognition treatment. In Section 355(a)(1)(D) t is provided that "as part of the distribution" the distributing orporation must "distribute" (i) all of the stock in the controlled orporation, or (ii) an amount of stock constituting "control" within he meaning of Section 368(c), Appendix A, infra. In the latter pro-ision "control" is defined as ownership of at least 80% of voting tock and 80% of all other stock of a corporation.

Reserving for later discussion the point that Pacific parted with nly 57% of the stock of Northwest in 1961, it should be clear that the erms "as part of the distribution" and "distributes" in Section 355(a) 1)(D) refer to the "distribution * * * with respect to its stock" equired by Section 355(a)(1)(A). That being so, the argument here hat Pacific did not distribute "control" of Northwest "with respect to ts stock" is a mere restatement of the prior argument with one ignificant difference; it provides a clearer answer to the reasoning f the Tax Court (I-R. 117):

> If Congress had intended that a distribution of the Northwest stock be treated as tax-free when made without consideration, it is inconceivable that it could have intended the transaction to result in taxable income to the distributees where they paid out money in connection with receiving such stock. [Emphasis in original.]

To be sure, Congress may grant or withhold tax benefits for a ound reason or for no reason at all. But when the distribution of control" requirement in Section 355(a)(1)(D) is viewed in the light

of the purpose of Section 355 and other nonrecognition provisions of the Code, a rational basis for disallowance emerges. It is beyond argument that the fundamental basis for nonrecognition of gain or loss under Section 355 (and the standard reorganization provisions) is that no tax should be imposed when the same people continue to own the same businesses with only formal changes in the business organization. These mere formal changes properly have been regarded by Congress as an inappropriate occasion for recognition of gain or loss by the shareholders.

Applying that principle to the facts of the case at bar, it will be observed that the issuance of transferable stock rights, the exercise of which requires substantial cash payments by the shareholders, predictabl[y] will diminish the continuity of ownership. Section 355(a)(1)(A) and (D) prevents the distributing corporation from erecting such a barrier to shareholder succession. Those provisions were designed to eliminate all such sale transactions by requiring that control be distributed with respect to the distributing corporation's stock -- i.e., transferred to the parent corporation's shareholders without requiring them to pay anything. Congress ran the risk that a shareholder of the distributing corporation receiving a share of the controlled corporation for nothing might turn around and sell it, privately "cashing in" on the distributing corporation's earnings and profits, but Congress wanted assurance that the process of distribution would not in itself give impetus to the impairment of the continuity of shareholder interest. Since Pacific did not distribute at least 80% of Northwest's stock (i.e., "control") to its shareholders without consideration, it did not meet the explicit

E. Pacific did not distribute control of Northwest in a single distribution as required by Section 355(a)(1)(D)

In any event, Section 355(a)(1)(D) unquestionably requires that the distributing corporation part with control (at least 80% of voting stock and all other stock) of the controlled corporation. This divestiture requirement was intended "to prevent a parent corporation from making periodic distributions of small amounts of stock and securities in a subsidiary as a substitute for ordinary dividends." Bittker, supra, p. 338. Beyond that, however, it will be demonstrated that if anything other than a single distribution was intended under Section 355(a)(1)(D), the provision would be administratively unworkable.

Pacific disposed of control of Northwest in successive and widely-spaced steps. In 1961 (the taxable year involved in this litigation) Pacific distributed stock purchase rights and sold only 57% of the Northwest common which it held. Not until 1963, almost two years later, did it dispose of the remaining 43% of Northwest common. Consequently, as of 1961, Pacific had divested itself of neither "all" of the Northwest common nor of 80% of it, as the statute plainly requires. The Tax Court accommodated itself to these facts with the conclusion that since the successive distributions had been planned that way from the outset, they added up to a single distribution within the purview of Section 355. (I-R. 109, fn. 4.)

Assuredly, it was not argued below and it is not argued now that Pacific did not plan to give up all of the Northwest stock within a span

of two years.[8] But it does seem odd that the state of mind of those in control of the distributing corporation should have the effect of transforming two distributions into one. Presumably, the Tax Court would have permitted Pacific to relinquish only 10% of the Northwest common which it owned each year for ten years (with "control" passing in the eighth year) so long as Pacific's management planned it that way. In the hypothetical case, Pacific's shareholders and the Commissioner would stand by for eight years (extending the period of limitations by consents) until it could be established that the disposition was indeed carried out as planned.

Other administrative difficulties would follow from the Tax Court's loose construction of the statute. Both Section 355(a)(1)(A) and Section 355(a)(1)(D) focus on the requirement that the distributing corporation be in "control" of the controlled corporation "immediately before" the distribution. Viewed from the other end, Section 355(b)(1)(requires that "immediately after the distribution" both the distributing and controlled corporation must be engaged in an active business, and Section 355(b)(2)(B) requires that such business must have been conducte for a period of five years ending on "the date of the distribution." Al of these requirements make it apparent that the date of the distribution is a pivotal moment in time upon which these objective tests depend. Cf. Helvering v. Southwest Corp., supra, pp. 201-202. The difficulty

8/ No independent argument was made below as to what distinguishes "a di- tribution" from "successive distributions" as a matter of law. That omi does not constitute any obstacle to consideration of the point on review this Court, since the legal argument presented here does not raise any n question of fact and does not question any finding of fact by the court below. See Jack Ammann Photogrammetric Engineers, Inc. v. Commissioner, 341 F. 2d 466 (C.A. 5th); Commissioner v. Chase Manhattan Bank, 259 F. 2 231, 237-238 (C.A. 5th); Smith Engineering Co. v. Rice, 102 F. 2d 492,

of determining whether an active business has been conducted for a period of five years ending on the "date of the distribution" would be reason enough for concluding that Congress contemplated only a single distribution occurring at a fixed point in time. Furthermore, Pacific surrendered its (80%) control of Northwest in 1961 and consequently did not have that requisite control of Northwest "immediately before" the second distribution in 1963. Section 355(a)(1)(A) and (a)(1)(D). In short, the physically separate dispositions of Northwest stock cannot be treated as a single transaction, for the years separating them cannot be made to fit within the word "immediately" and the term "the date."

Of course, the foregoing does not mean that the shareholders of the distributing corporation must physically receive the controlled corporation's stock on any particular day. All that is contended here is that some date must be capable of being viewed as the date on which the distribution took place. It is sufficient for present purposes that the Tax Court misinterpreted Section 355 when it held that a series of separate distributions stretching over a period of almost two years could be treated as a "single distribution" simply because they were planned that way.

F. Northwest acquired telephone businesses from Pacific in a transaction in which gain was "recognized" within the purview of Section 355(b)(2)(C)

The general structure of Section 355 is a laying out of four cumulative conditions to nonrecognition treatment in subsections (a)(1)(A) through (a)(1)(D). Subsection (a)(1)(C) simply states that the requirements

of subsection (b) relating to active businesses, must be satisfied. The additional detailed conditions of Section 355(b) thus incorporated are as lengthy as Section 355(a)(1) in its entirety. The single point in this mass of technical language upon which this portion of the argument is focused is the qualification for nonrecognition treatment specified in Section 355(b)(2)(C), i.e., that the active business of the controlled corporation _not_ be acquired by it "in a _transaction_ in which gain or loss was recognized in whole or in part." (Emphasis supplied.)

The telephone businesses were acquired by Northwest in a transaction in which gain was required to be recognized "in part" under Section 351, Appendix A, _infra_. Northwest obtained its operating assets from Pacific in exchange for its common stock and a $200,000,000 demand note. Section 351(a) provides that no gain or loss shall be recognized on the transfer of property to a controlled corporation "solely in exchange for stock or securities." The $200,000,000 demand note was not a security within the meaning of Section 351(a).[9] Nonrecognition _was_ not lost as to Pacific's receipt of Northwest stock, but the value of the note ("boot") was taxable to Pacific as "other property" under Section 351(b).

The Tax Court held, however, that whether or not the transaction in question could be characterized as one in which gain was recognizable in part, Pacific did not in fact recognize gain, which, in the Tax Court's view, was determinative. (I-R. 121.) At the end of 1961, American filed a consolidated income tax return which included both Pacific and Northwest,

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9/ Corporate notes qualify as securities only when they are of sufficient duration to represent a substantial continuing interest in the corporation. See _Lloyd-Smith_ v. _Commissioner,_ 116 F. 2d 642 (C.A. 2d), and _Cortland Specialty Co_. v. _Commissioner,_ 60 F. 2d 937 (C.A. 2d).

and any gain from inter-company transactions properly was eliminated on the consolidated return, i.e., Pacific did not report any gain on account of the receipt of the $200,000,000 demand note. (I-R. 98.) Although it is not disputed that Pacific's gain properly was "eliminated" on the consolidated return, the question which remains is whether Congress, in disqualifying a transaction from Section 355 benefits if gain or loss was "recognized" on the acquisition of a business, used that term only in the context of other nonrecognition provisions of Subchapter C, or intended qualification under Section 355 to hinge upon whether the corporations involved decided to file a consolidated income tax return at the end of the year.

Parenthetically, it must be observed that the Tax Court, in its consideration of the other provisions of Section 355, seemed preoccupied with the question of whether literal interpretations urged by the Commissioner might frustrate the legislative purpose behind Section 355. Yet, at this point in its deliberations, the Tax Court apparently never considered what intelligible legislative purpose would be served by making qualification under Section 355 depend upon the happenstance that an affiliated group of corporations subsequently elected to file a consolidated return.

It is far more reasonable to conclude that in Section 355(b)(2)(C) Congress was concerned with the character of the transaction in which the business was acquired and did not intend to make controlling other sections of the Internal Revenue Code which have no direct relation to corporate distributions and adjustments. Viewed in that light, the character of the transaction in which Northwest acquired the telephone businesses from Pacific was one in which gain was recognized "in part"

under Section 351, and for the purposes of qualifying for Section 355 benefits, that character is controlling. The manner in which the businesses were acquired -- the character of the transaction -- was the subject of legislative concern, and the unrelated option to report income on a consolidated return (eliminating inter-company profit) does not relate back to change the character of such transaction. 10/

CONCLUSION

For the reasons stated, Section 355 is not applicable to the facts of this case, and the decision of the Tax Court that it is should be reversed. The Tax Court may consider on remand the alternative arguments of taxpayers based on other provisions of the Code.

Respectfully submitted,

RICHARD C. PUGH,
Acting Assistant Attorney General.

LEE A. JACKSON,
GILBERT E. ANDREWS,
MARTIN T. GOLDBLUM,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

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10/ Sections 356(b) and 361(b), Appendix A, *infra*, provide that when "boot is received it is taxable either to the corporation receiving it or (if distributed by the corporation to its shareholders) to the shareholders. Which of the two happens to receive the "boot" has no bearing on whether the reorganization falls within the terms of the nonrecognition provisions If, in the instant case, Pacific had distributed the $200,000,000 demand note (or its proceeds) to its shareholders, they would have recognized gain "in part" on the distribution and Section 355(b)(2)(C) would disquali nonrecognition treatment on the subsequent exercise of the stock rights. follows that Congress did not intend the qualification of a transaction under Section 355 to turn on whether Pacific decided to retain or distribu the note.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: ______________________________ day of ____________________, 1966.

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Attorney

APPENDIX A

Internal Revenue Code of 1954:

SEC. 301. DISTRIBUTIONS OF PROPERTY.

(a) In General.--Except as otherwise provided in this chapter, a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

*   *   *

(c) Amount Taxable.--In the case of a distribution to which subsection (a) applies --

(1) Amount constituting dividend.--That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

(2) Amount applied against basis.--That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.

(3) Amount in excess of basis.--

(A) In general.--Except as provided in subparagraph (B), that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock, shall be treated as gain from the sale or exchange of property.

(B) Distributions out of increase in value accrued before March 1, 1913.--That portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock and to the extent that it is out of increase in value accrued before March 1, 1913, shall be exempt from tax.

*   *   *

(26 U.S.C. 1964 ed., Sec. 301.)

SEC. 311. TAXABILITY OF CORPORATION ON DISTRIBUTION.

(a) General Rule.--Except as provided in subsections (b) and (c) of this section and section 453(d), no gain or loss shall be recognized to a corporation on the distribution, with respect to its stock, of--

(1) its stock (or rights to acquire its stock), or

(2) property.

* * *

(c) Liability in Excess of Basis.--If--

(1) a corporation distributes property to a shareholder with respect to its stock,

(2) such property is subject to liability, or the shareholder assumes a liability of the corporation in connection with the distribution, and

(3) the amount of such liability exceeds the adjusted basis (in the hands of the distributing corporation) of such property,

then gain shall be recognized to the distributing corporation in an amount equal to such excess as if the property distributed had been sold at the time of the distribution. In the case of a distribution of property subject to a liability which is not assumed by the shareholder, the amount of gain to be recognized under the preceding sentence shall not exceed the excess, if any, of the fair market value of such property over its adjusted basis.

(26 U.S.C. 1964 ed., Sec. 311.)

SEC. 351. TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.

(a) General Rule.--No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation. For purposes of this section, stock or securities issued for services shall not be considered as issued in return for property.

(b) Receipt of Property.--If subsection (a) would apply to an exchange but for the fact that there is received, in addition to the stock or securities permitted to be received under subsection (a), other property or money, then--

(1) gain (if any) to such recipient shall be recognized, but not in excess of--

(A) the amount of money received, plus

(B) the fair market value of such other property received; and

(2) no loss to such recipient shall be recognized.

(c) Special Rule.--In determining control, for purposes of this section, the fact that any corporate transferor distributes part or all of the stock which it receives in the exchange to its shareholders shall not be taken into account.

* * *

(26 U.S.C. 1964 ed., Sec. 351.)

SEC. 355. DISTRIBUTION OF STOCK AND SECURITIES OF A CONTROLLED CORPORATION.

(a) Effect on Distributees.--

(1) General rule.--If--

(A) a corporation (referred to in this section as the "distributing corporation")

(i) distributes to a shareholder, with respect to its stock, or

(ii) distributes to a security holder, in exchange for its securities,

solely stock or securities of a corporation (referred to in this section as "controlled corporation") which it controls immediately before the distribution,

(B) the transaction was not used principally as a device for the distribution of earnings and profits of the distributing corporation or the controlled corporation or both (but the mere fact that subsequent to the distribution stock or securities in one or more of such corporations are sold or exchanged by all or some of the distributees (other than pursuant to an arrangement negotiated or agreed upon prior to such distribution) shall not be construed to mean that the transaction was used principally as such a device),

(C) the requirements of subsection (b) (relating to active businesses) are satisfied, and

(D) as part of the distribution, the distributing corporation distributes--

(i) all of the stock and securities in the controlled corporation held by it immediately before the distribution, or

(ii) an amount of stock in the controlled corporation constituting control within the meaning of section 368(c), and it is established to the satisfaction of the Secretary or his delegate that the retention by the distributing corporation of stock (or stock and securities) in the controlled corporation was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax,

then no gain or loss shall be recognized to (and no amount shall be includible in the income of) such shareholder or security holder on the receipt of such stock or securities.

(2) Non pro rata distributions, etc.--Paragraph (1) shall be applied without regard to the following:

(A) whether or not the distribution is pro rata with respect to all of the shareholders of the distributing corporation,

(B) whether or not the shareholder surrenders stock in the distributing corporation, and

(C) whether or not the distribution is in pursuance of a plan of reorganization (within the meaning of section 368(a)(1)(D)).

(3) Limitation.--Paragraph (1) shall not apply if--

(A) the principal amount of the securities in the controlled corporation which are received exceeds the principal amount of the securities which are surrendered in connection with such distribution, or

(B) securities in the controlled corporation are received and no securities are surrendered in connection with such distribution.

For purposes of this section (other than paragraph (1)(D) of this subsection) and so much of section 356 as relates to this section, stock of a controlled corporation acquired by the distributing corporation by reason of any transaction which occurs within 5 years of the distribution of such stock and in which gain or loss was recognized in whole or in part, shall not be treated as stock of such controlled corporation, but as other property.

(4) Cross reference.--

For treatment of the distribution if any property is received which is not permitted to be received under this subsection (including an excess principal amount of securities received over securities surrendered), see section 356.

(b) Requirements as to Active Business.--

(1) In general.--Subsection (a) shall apply only if either--

(A) the distributing corporation, and the controlled corporation (or, if stock of more than one controlled corporation is distributed, each of such corporations), is engaged immediately after the distribution in the active conduct of a trade or business, or

(B) immediately before the distribution, the distributing corporation had no assets other than stock or securities in the controlled corporations and each of the controlled corporations is engaged immediately after the distribution in the active conduct of a trade or business.

(2) Definition.--For purposes of paragraph (1), a corporation shall be treated as engaged in the active conduct of a trade or business if and only if--

(A) it is engaged in the active conduct of a trade or business, or substantially all of its assets consist of stock and securities of a corporation controlled by it (immediately after the distribution) which is so engaged,

(B) such trade or business has been actively conducted throughout the 5-year period ending on the date of the distribution,

(C) such trade or business was not acquired within the period described in subparagraph (B) in a transaction in which gain or loss was recognized in whole or in part, and

(D) control of a corporation which (at the times of acquisition of control) was conducting such trade or business--

(i) was not acquired directly (or through one or more corporations) by another corporation within the period described in subparagraph (B), or

(ii) was so acquired by another corporation within such period, but such control was so acquired only by reason of transactions in which gain or loss was not recognized in whole or in part, or only by reason of such transactions combined with acquisitions before the beginning of such period.

(26 U.S.C. 1964 ed., Sec. 355.)

SEC. 356. RECEIPT OF ADDITIONAL CONSIDERATION.

(a) Gain on Exchanges.--

(1) Recognition of gain.--If--

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in the amount not in excess of the sum of such money and the fair market value of such other property.

(2) Treatment as dividend.--If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property.

(b) Additional Consideration Received in Certain Distributions.--If--

(1) section 355 would apply to a distribution but for the fact that

(2) the property received in the distribution consists not only of property permitted by section 355 to be received without the recognition of gain, but also of other property or money,

then an amount equal to the sum of such money and the fair market value of such other property shall be treated as a distribution of property to which section 301 applies.

* * *

(26 U.S.C. 1964 ed., Sec. 356.)

SEC. 361. NONRECOGNITION OF GAIN OR LOSS TO CORPORATIONS.

(a) General Rule.--No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(b) Exchanges Not Solely in Kind.--

(1) Gain.--If subsection (a) would apply to an exchange but for the fact that the property received in exchange consists not only of stock or securities permitted by subsection (a) to be received without the recognition of gain, but also of other property or money, then--

(A) if the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(B) if the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * *

(26 U.S.C. 1964 ed., Sec. 361.)

SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

*　　　　　　*　　　　　　*

(c) Control.--For purposes of part I (other than section 304), part II, and this part, the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporations.

(26 U.S.C. 1964 ed., Sec. 368.)

SEC. 1001. DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS.

(a) Computation of Gain or Loss.--The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

*　　　　　　*　　　　　　*

(26 U.S.C. 1964 ed., Sec. 1001.)

SEC. 1002. RECOGNITION OF GAIN OR LOSS.

Except as otherwise provided in this subtitle, on the sale or exchange of property the entire amount of the gain or loss, determined under section 1001, shall be recognized.

(26 U.S.C. 1964 ed., Sec. 1002.)

Treasury Regulations on Income Tax (1954 Code):

§1.355-1. Distribution of stock and securities of controlled corporations.

(a) Application of section. * * * For the purpose of section 355, stock rights or stock warrants are not included in the term "stock and securities."

*　　　　　　*　　　　　　*

(26 C.F.R., §1.355-1.)

§1.355-2. Limitations.

*   *   *

(c) Business purpose. * * * Section 355 contemplates a continuity of the entire business enterprise under modified corporate forms and a continuity of interest in all or part of such business enterprise on the part of those persons who, directly or indirectly, were the owners of the enterprise prior to the distribution or exchange. * * *

*   *   *

(26 C.F.R., §1.355-2.)

APPENDIX B

All exhibits were admitted upon the stipulation of the parties and were incorporated in and made a part of the consolidated stipulation of facts. (I-R. 26.) A table (I-R. 71-78) lists and describes each exhibit, and sets forth the page wherein reference is made to it in the consolidated stipulation of facts (I-R. 26-70).

No. 20,863

United States Court of Appeals
For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

OSCAR E. BAAN and EVELYN K. BAAN,
Respondents.

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR RESPONDENTS

HARRY R. HORROW,
STEPHEN J. MARTIN,
225 Bush Street,
San Francisco, California 94104,
Attorneys for Respondents.

PILLSBURY, MADISON & SUTRO,
225 Bush Street,
San Francisco, California 94104,
Of Counsel.

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Table of Contents

	Page
Opinion below and jurisdiction	1
Questions presented	1
Statutes and regulations involved	3
Statement of the case	3
Argument	15
I. The Tax Court properly held that section 355 applied to the Northwest stock received by taxpayers through the exercise of their rights, and that taxpayers did not receive a taxable dividend thereby as the Commissioner erroneously determined	15
A. Pacific "distributed" Northwest stock to taxpayers "with respect to its stock," as required by section 355(a)(1)(A)	22
B. Distribution by Pacific of all of the stock of Northwest satisfied the transfer of control requirement of section 355(a)(1)(D)	29
C. Section 355(a)(1)(D) does not require a single distribution of control of Northwest, as petitioner contends	32
D. When Northwest acquired its telephone businesses from Pacific in exchange for stock and a demand note, no gain was recognized in whole or in part, within the meaning of section 355(b)(2)(C)	37
E. In any event, even if nonrecognition of gain on the transfer of assets to Northwest is required under section 351, the demand note of Northwest was a security permitted to be received tax free by Pacific under that section	40
II. If for any reason this Court should hold that section 355 is not applicable to the facts of this case, this case should be remanded to the Tax Court for consideration of the alternative contentions of taxpayers that the Commissioner's determination is erroneous	43
Summary of Argument	44
Conclusion	49
Appendix	i

Table of Authorities Cited

Cases — Pages

Dollar, Robert, Co., 18 T.C. 444 27

Gilbert v. C.I.R., 262 F.2d 512, certiorari denied 359 U.S. 1002 41

Halliburton v. Commissioner of Internal Revenue, 78 F.2d 265 33

Helvering v. Bartlett, 71 F.2d 598 20

Kruse, O. H., Grain & Milling v. C.I.R., 279 F.2d 123 41

Palmer v. Commissioner, 302 U.S. 63 .... 17, 19, 20, 21, 23, 45

Portland Oil Co. v. Commissioner of Internal Revenue, 109 F.2d 479, certiorari denied, 310 U.S. 650 33

Securities Co. v. Commissioner of Internal Revenue, 64 F.2d 330 27

Timberlake v. Commissioner of Internal Revenue, 132 F.2d 259 18

Turner Construction Company v. United States, 364 F.2d 525 43

Statutes

Internal Revenue Code of 1954:

- Sec. 301 .... 13, 18, 19, 24, 25
- Sec. 301(a) 25
- Sec. 301(b) 18
- Sec. 301(c) 13
- Sec. 301(c)(1) 25
- Sec. 316 13
- Sec. 346(b) 43, 48
- Sec. 351 .... 33, 38, 39, 40, 41, 42, 43, 47, 48
- Sec. 351(a) 41
- Sec. 354 .... 27, 43, 45, 48
- Sec. 355(a)(1) 16
- Sec. 355(a)(1)(A) 22, 23, 25, 26, 45
- Sec. 355(a)(1)(A)(i) 25, 26, 33
- Sec. 355(a)(1)(A)(ii) 25

Pages

Sec. 355(a)(1)(B) 30
Sec. 355(a)(1)(D) 29, 30, 31, 32, 34, 37, 46
Sec. 355(a)(2) 25
Sec. 355(a)(2)(C) 34
Sec. 355(b)(1)(A) 37
Sec. 355(b)(2)(B) 37
Sec. 355(b)(2)(C) 37, 38, 39, 40, 47
Sec. 356 ....27, 45
Sec. 368 34

Revenue Act of 1934 33

United States Code:
Title 1, section 1 33

Treasury Regulations

Income Tax Regulations:
Sec. 1.301-1(j) 18, 26
Sec. 1.351-1(a)(1) 34
Sec. 1.1502-11 39
Sec. 1.1502-31(b)(1) 14

Congressional Reports

Senate Report 1622, 83d Congress, 2d Session (p. 266) 34, 40

Other Authorities

Cohen, et al., Corporate Distributions, etc., Harvard Law Review (1954-1955) Vol. 68, page 393 40

3 Mertens, Law of Federal Income Taxation, section 20.161 34

Revenue Ruling 57-311 (C.B. 1957-2, 243) 34

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On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR RESPONDENTS

OPINION BELOW AND JURISDICTION

The opinion below and the basis for jurisdiction of this Court are as stated in petitioner's brief (Pet. Br. 1-2).[1]

QUESTIONS PRESENTED

The Pacific Telephone and Telegraph Company ("Pacific"), by action of its board of directors, approved by its shareholders, adopted a plan of reorganization in 1961 pursuant to which the telephone communications businesses conducted by Pacific in the three States of Oregon, Washington, and a portion of Idaho contiguous

[1]Respondents will use the same form of reference to the record as used in petitioner's brief. Volume I will be referred to as "I-R.," and Volume II will be referred as as "II-R."

to the State of Washington, were divided from the telephone communications business of Pacific in the State of California. Pursuant to this plan, Pacific transferred all of the assets and liabilities pertaining to the operations in the States of Oregon, Idaho and Washington to a newly organized corporation, Pacific Northwest Bell Telephone Company ("Northwest"), in exchange for a single class of Northwest common stock and a $200 million interest-bearing demand note. Pursuant to the plan, Pacific issued to all of its shareholders rights, represented by short-term transferable stock purchase warrants, to purchase all of the common stock of Northwest at a price of $16 per share. Rights to purchase 57 per cent of the Northwest stock at said price were issued by Pacific to its shareholders in 1961, and rights to purchase the remainder of said Northwest stock were issued by Pacific to its shareholders in 1963. The $200 million demand note was refunded by sales to the public by Northwest between 1961 and 1963 of four issues of 20-year debentures in the amounts of $50 million each. Respondents, herein referred to as taxpayers, owners of 600 shares of common stock of Pacific, received 600 rights in 1961 to purchase Northwest common stock, which rights were exercised by them on October 11, 1961, when the fair market value of the Northwest stock was $26.94 per share.[2]

The Commissioner determined in his deficiency notice that the receipt of the Northwest stock by taxpayers in

---

[2]Petitioner inadvertently misstated that the Northwest stock on the date of purchase had a fair market value of $26 per share (Pet. Br. 2). The stipulation (I-R. 65), in accordance with the Commissioner's determination (I-R. 20), correctly stated the amount on October 11, 1961, the date of exercise of the rights, as $26.94.

1961 on the exercise of their rights was taxable as a dividend distributed by Pacific, measured by the difference between the fair market value of the Northwest stock at the date of exercise, $26.94, and the amount paid in exercise of the rights, $16 a share.

The Tax Court held that section 355 of the Internal Revenue Code of 1954[3] was applicable to the distribution of the Northwest stock to the taxpayers, and that the exercise of the rights to purchase Northwest stock did not result in any taxable income.

The only question presented on this appeal is whether the Tax Court erred in rejecting the Commissioner's determination and in ruling that section 355 was applicable. The Tax Court's ruling sustained the primary contention made by the taxpayers, and the Tax Court therefore found it unnecessary to pass on alternative contentions of the taxpayers referred to herein.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations set forth in the Appendix, infra, are the pertinent statutory provisions and Treasury Regulations.

STATEMENT OF THE CASE

While petitioner's statement of the facts is substantially accurate so far as it goes, certain significant facts have

[3]Section references throughout will be to the Internal Revenue Code of 1954 unless otherwise expressly stated. Section 355 appears in the Appendix to this brief (App. v-ix).

been omitted. To assist the Court, a more complete statement of the pertinent facts is set forth.

Taxpayers Oscar E. Baan and Evelyn K. Baan, husband and wife and residents of Sausalito, California, throughout 1961 owned 600 shares of the common stock of The Pacific Telephone and Telegraph Company, a California corporation (I-R. 80-81). Pacific furnishes communications services, including local and long distance (toll) telephone services, in the State of California. Prior to July 1, 1961, it furnished such services also in the States of Oregon, Washington and a northern portion of Idaho contiguous to the State of Washington. Pacific Northwest Bell Telephone Company, a Washington corporation, commencing on July 1, 1961, has continuously furnished such services in the territory formerly served by Pacific in Oregon, Washington and Idaho (I-R. 81). In each state in which they operate, Pacific and Northwest are each subject to regulation by a state public utility regulatory authority having jurisdiction over many aspects of the business, including security issues, purchases and sales of property and the like. Both are likewise subject to regulation by the Federal Communications Commission to the extent their business is interstate (I-R. 82).

American Telephone and Telegraph Company ("American"), a New York corporation, has since 1907 owned more than 80 per cent of each class of stock of Pacific. In 1961, American owned 21 telephone company subsidiaries, including Pacific and Northwest, which operated in every state except Hawaii and Alaska (I-R. 82-83).

In 1961, Pacific's capital stock consisted of $82 million par value of $100 par voting preferred stock and ap-

proximately $1,500,000,000 par value of $14-2/7ths par value common stock (I-R. 84). Pacific's articles of incorporation did not contain any provision for redemption of the preferred stock (Exh. 2-B(1)). In 1961, Pacific had enough earnings and profits to cover the amount which petitioner contends was distributed as a dividend (I-R. 84).

Because of its expanding business, Pacific required a relatively continuous flow of large amounts of new capital (Exh. 10-J). The financing technique Pacific had worked out was to obtain temporary financing through advances from American, evidenced by demand notes due one day after issuance, bearing 4½ per cent interest. Pacific would discharge such advances periodically from the proceeds of issues of its common stock and long-term debentures. In 1961, Pacific's long-term funded debt stood at $902 million (I-R. 84-85). In 1961, American owned about 90 per cent of Pacific's common stock and about 78 per cent of the preferred stock, in the aggregate 89.62 per cent of the voting power. The minority common and preferred shareholders numbered over 38,000. Pacific's common and preferred stock had for many years been listed and traded on the New York and Pacific Coast stock exchanges (I-R. 85). Since 1954, Pacific had each year been included as an affiliated subsidiary corporation in the consolidated Federal income tax return of American. Commencing with 1961, this return included Northwest as well (I-R. 86).

It was stipulated that Pacific's operations in Oregon, Washington and Idaho prior to July 1, 1961, constituted one or more telephone businesses which were separable

from the California business which Pacific has continued to operate (I-R. 87).

Since World War II, Pacific's business had mushroomed four or five times in size, and the growth was expected to continue at the same rate, particularly in view of the expanding population in California. In terms of capital, Pacific was American's largest subsidiary, and was the eighth largest nonfinancial company in the United States. Its operating territory included one seventh of the continental United States (I-R. 87-88). The growth and enormous size of Pacific generated severe administrative problems, and caused management concern that the company was getting too big to do an effective job (I-R. 88; Exh. 17-Q, President's letter). John O. Einerman, vice president and comptroller, and formerly an officer of American, was asked in 1958 to undertake studies looking toward division of Pacific into two or three corporations. These studies culminated in a plan for reorganization which was first adopted by the directors on January 27, 1961, on Mr. Einerman's recommendation, and was then approved by the shareholders at their annual meeting on March 24, 1961 (I-R. 88-89).[4]

The plan for reorganization provided that Pacific would transfer all of its business and properties in Oregon, Washington and Idaho to Northwest, in exchange for (a) the assumption by Northwest of certain operating liabilities relating to the assets transferred; (b) all of Northwest's single class of capital stock; and (c) a $200

[4]The complete plan for reorganization is contained in Exhibit 17-Q, pages 8-13.

million demand note of Northwest bearing $4\frac{1}{2}$ per cent interest. An integral part of the plan for reorganization was the offering of the Northwest stock to the Pacific shareholders through rights. The first such offering was made in 1961, and the remainder of the Northwest stock was offered in 1963. The plan contemplated that American would exercise all of the rights it was entitled to receive and that American, after completion of the plan, would own about 89 per cent of the Northwest stock (I-R. 91-92; Exh. 17-Q, pp. 8, 10-12).

The advantages of having the business in Oregon, Washington and Idaho operated by a separate corporation owned directly by the Pacific shareholders were considered to be as follows:

1. Top authority closer to communities served;

2. Better recognition of service needs of each community;

3. More flexibility in dealing with customers;

4. Closer relations with employees;

5. Better understanding by public and authorities;

6. More efficient operations;

7. Financing problems, as well as operating problems, would be assumed by Northwest's management;

8. A board of directors with final authority, drawn from the territory served, would replace the then-existing advisory boards; and

9. Pacific's management would be able to concentrate full attention on the needs of California and Nevada (I-R. 90).

The offering of the Northwest stock through the issuance of rights to the shareholders of Pacific pursuant to the plan was intended to serve the additional purpose of providing Pacific with capital funds required by Pacific for operations in California. In each of the seven preceding 12-month periods ended June 30, 1960, Pacific issued common stock and/or long-term debentures in a total amount of $1,313,750,000, or an average for each of the seven years of $187,678,600. In the 36-month period from July 1, 1960, through June 30, 1963, Pacific did not issue any additional common stock or debentures (I-R. 92-93).

Before adopting the plan, the management of Pacific considered various alternative proposals for distribution of the Northwest shares. One such proposal was the distribution of the Northwest shares to the shareholders of Pacific without the payment by them of any consideration. This was dropped because Pacific's management was advised by its attorneys that it would be required to charge such a distribution to earned surplus, and it had insufficient surplus for this purpose. Pacific's management was advised that it could create a reduction surplus out of capital against which a distribution of the shares of Northwest could be charged, but such a reduction surplus would be required under California law to be used first to redeem all of the preferred shares of Pacific. Pacific's management was advised and believed that under California law Pacific's preferred shares were not subject to redemption. In addition, the desire of Pacific to raise new capital from the distribution of the Northwest shares would not have been fulfilled by such a method (I-R. 93).

After obtaining the necessary approvals of the regulatory authorities, Pacific caused the organization of Northwest, and on June 30, 1961, transferred all of its business and properties in Oregon, Washington and Idaho to Northwest in exchange for the consideration contemplated by the plan. In addition to the $200 million demand note and the liabilities assumed, this included a total of 30,460,000 shares of $11 par capital stock, having an aggregate par value of $335,060,000. Thereupon Pacific ceased, and Northwest commenced, operation of the telephone business in Oregon, Washington and Idaho (I-R. 94-96).

The total capitalization of Northwest was arranged in such a way as to maintain substantially the same ratios of stock, aggregate debt and surplus as those of Pacific immediately prior to the transfer of assets. The $200 million demand note of Northwest corresponded to the long-term debentures in the capital structure of Pacific (I-R. 97). The plan provided that within about three years Northwest would refund the demand note through issuance of its own long-term debentures to the public (Exh. 17-Q, pp. 11, 13). Pursuant to the plan this refinancing was carried out through four issues of 20-year debentures of Northwest of $50 million each, the last issue occurring in December, 1963 (I-R. 63).

In American's consolidated income tax return for 1961, no gain or loss was reported on the transfer of the Pacific assets to Northwest (I-R. 98).

Pursuant to the plan, on September 29, 1961, Pacific issued to its shareholders of record on September 20,

1961,[5] rights evidenced by assignable warrants to purchase about 57 per cent of the Northwest stock. Six rights and the payment of $16 were required for the purchase of each share of Northwest. The rights would expire, if not exercised, on October 20, 1961. Both the capital stock of Northwest and the rights were listed for trading on the American and Pacific Coast stock exchanges, and trading with respect to each commenced, at first on a when-issued basis, on September 14, 1961 (I-R. 98-99).

On October 11, 1961, taxpayers exercised all of their 600 rights received from Pacific, and acquired thereby 100 shares of Northwest upon the payment to Pacific of $1,600 (I-R. 100). In their joint Federal income tax return for 1961, taxpayers reported no income or loss from either the receipt or exercise of the Northwest rights (I-R. 65). On September 29, 1961 (the date of issuance of the rights), the value of the Northwest stock determined by public trading was $26.81 and the value of the rights similarly determined was $1.77. On October 11, 1961, the day taxpayers exercised their rights, the two values were $26.94 and $1.80, respectively (I-R. 20, 65; Exhs. 48-VV and 49-WW). The amount which petitioner is here contending the taxpayers received as a dividend from Pacific is the ''spread'' between the $26.94 value on October 11, 1961, and the $16 offering price (I-R. 20).

As called for by the plan, American exercised all the rights which it received in 1961, and acquired 15,548,140 shares of Northwest. The minority common and preferred shareholders of Pacific exercised rights to acquire

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[5]Petitioner erroneously stated that the rights were issued on the record date (Pet. Br. 5).

1,897,891 Northwest shares. The shares of Northwest thus acquired by the Pacific shareholders in 1961 had an aggregate fair market value of about $470 million, while Pacific received cash in the amount of about $280 million. American's consolidated return for 1961 included taxable gain on the sale by Pacific of Northwest stock to the minority shareholders of $8,739,362.07, but eliminated gain on the sale of such stock to American, as an intercompany transaction (I-R. 101; Exh. 54-BBB).

The offering price under the 1961 rights was set at a meeting of Pacific's directors on August 25, 1961, at which they adopted the recommendation of Mr. Einerman. Mr. Einerman presented to the board a number of factors which he had taken into account (I-R. 102-103). In making his pricing recommendation, Einerman testified that he did not intend to recommend to the board that a dividend distribution be made in this manner (II-R. 34-35, 37).

Pursuant to the plan, Pacific in June, 1963, issued additional rights to its shareholders, permitting them to purchase the remaining 43 per cent of the Northwest stock held by Pacific. The offering price was again set at $16 per share, but this time 8 rights were required to be exercised for each share. The offering price was set after consideration of essentially the same factors which the board had considered in 1961. As contemplated by the plan, American exercised all of the rights it received, and when the plan was completed, owned about 89 per cent of the capital stock of Northwest. The minority common and preferred shareholders of Pacific owned another 6 per cent (I-R. 104-105; Exh. 54-BBB).

Under the plan there were two offerings of Northwest stock: (1) because of the enormous amount of stock involved, and (2) because of a desire to avoid the receipt by Pacific of more capital, on which it would feel obligated to pay dividends, than it could use currently in its business (II-R. 40, 58-60, 68; Exh. 15-O, pp. 5 and 6). The Tax Court found that the two offerings of Northwest stock were component parts of a single plan and that they must be regarded together as resulting in the disposition of 100 per cent of the Northwest stock (I-R. 109, n. 4).

The Commissioner of Internal Revenue issued his advance ruling (opinion) letter on June 28, 1961, regarding the tax consequences of the planned division of Pacific and distribution of Northwest stock to the shareholders of Pacific through an issue of rights, in part as follows (Exh. 67-OOO, pp. 5-6):

> "(6) The receipt by the shareholders of the Pacific Company of rights to purchase shares of stock of the Northwest Company will not result in taxable income to the shareholders.
>
> "(7) No taxable income will result to the shareholders of the Pacific Company by reason of holding the above-described rights to purchase shares of stock of the Northwest Company until the date of expiration of the rights, without having exercised, sold or exchanged them.
>
> "(8) The full amount realized by the shareholders of the Pacific Company upon the sale or exchange of the above-described rights to purchase shares of stock of the Northwest Company will constitute ordi-

nary income to the shareholder so selling or exchanging the rights.

"(9) The receipt by the shareholders of the Pacific Company of stock of the Northwest Company upon the exercise of the above-described rights, in case of each shareholder which is not a corporation, will result in a distribution of property under section 301 of the Code in an amount equal to the excess, if any, of the fair market value of the stock of the Northwest Company at the time of the exercise of the rights over the amount paid for the stock; and, in the case of each shareholder which is a corporation, will result in a distribution of property under section 301 [App. i-iii] in an amount equal to the excess, if any, of the basis of the stock of the Northwest Company in the hands of the Pacific Company at the time of the exercise of the rights over the amount paid for the stock, assuming the basis of such stock is less than its fair market value.

"The amount of the distribution, as determined above, will constitute a dividend to the extent provided for in sections 301(c) and 316 of the Code.

"Section 355 of the Code will not be applicable to the receipt by the shareholders of the Pacific Company of stock of the Northwest Company upon exercise of the above-described rights.

"If a consolidated return is filed for the taxable year in which the American Company exercises its rights to purchase stock of the Northwest Company, the dividend distribution will constitute an intercom-

pany transaction to be eliminated under the provisions of section 1.1502-31(b)(1) [App. xxvi-xxvii] of the regulations.''

After an audit of the taxpayers' return filed for 1961, the Commissioner issued his statutory notice of an income tax deficiency. In arriving at the deficiency determined against the taxpayers in this proceeding, the Commissioner followed his advance ruling under (9) above. The Commissioner determined that the receipt of the Northwest stock by the taxpayers on the exercise of their rights resulted in a taxable dividend to them in the amount of the difference between the fair market value of the Northwest stock at the date of exercise of the rights ($26.94) and the amount of $16 per share paid (I-R. 20). The Tax Court decided that section 355 was applicable to the receipt of the Northwest stock by the taxpayers and that they did not receive any taxable dividend. The court found it unnecessary to pass on other alternative contentions made by the taxpayers in support of their position that no taxable dividend income was received by them on the exercise of their rights (I-R. 111). From this holding the Commissioner has filed his petition for review. (A summary of taxpayers' argument appears *infra,* pages 44-48).

ARGUMENT

I

THE TAX COURT PROPERLY HELD THAT SECTION 355 APPLIED TO THE NORTHWEST STOCK RECEIVED BY TAXPAYERS THROUGH THE EXERCISE OF THEIR RIGHTS, AND THAT TAXPAYERS DID NOT RECEIVE A TAXABLE DIVIDEND THEREBY AS THE COMMISSIONER ERRONEOUSLY DETERMINED.

Following World War II, the telephone businesses operated by Pacific in the States of California, Oregon, Washington and Idaho experienced enormous growth, which was expected to continue. The administrative problems resulting from the scope of Pacific's operations and the territory they embraced led to the formulation of a plan for the separation of the businesses and assets of Pacific in the three States of Oregon, Washington and Idaho into a new corporation, Northwest, to have a separate management, and to be owned by the Pacific shareholders. Pacific was advised by its attorneys that it was not possible under the California corporation law to distribute the stock of Northwest to its shareholders prorata out of its capital or surplus. At the same time, Pacific was faced with a need for large amounts of capital funds to provide new plant and equipment for its expanding operations in California.

Had Pacific transferred its assets in the States of Oregon, Washington and Idaho to Northwest for its common stock, and distributed such stock to its shareholders, there would have occurred, in the language of the Tax Court, "a classic case of a tax-free divisive reorganization," or spinoff, to which section 355 (App. v-ix) was clearly addressed (I-R. 115). This much is not disputed by petitioner (Pet. Br. 13-14).

Laying aside the demand note question raised by petitioner, which is discussed at pages 37-43 below, the only factor present here not present in the classic tax-free spinoff case was that the distribution of the Northwest stock was conditioned upon payment of $16 a share by the Pacific shareholders to Pacific (I-R. 117). Such cash payment served the additional purpose of providing needed capital for Pacific's operations in California (I-R. 92). The means whereby the Northwest stock was distributed by Pacific to the Pacific shareholders was the issuance to them of short-term rights, which required the payment of cash by them to Pacific, in order to receive the Northwest stock. Petitioner's contention that the transfer by Pacific of the Northwest stock to its shareholders was not governed by section 355 essentially revolves around the use of these short-term rights as the vehicle for the distribution of the Northwest stock to the Pacific shareholders. Admittedly, if section 355 applies to the receipt of the Northwest stock by taxpayers, no amount is includible in their income on the receipt of the Northwest stock.[6]

In order to resolve the questions raised by this appeal, it is necessary that a proper analysis be made of the rights to purchase the Northwest stock. Throughout petitioner's brief is a basic misconception of the proper tax treatment of the rights involved in this case. Whether by inadvertence or design, petitioner's brief views these rights in a manner which is irreconcilable with the Com-

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[6]Section 355(a)(1) provides in part: "* * * then no gain or loss shall be recognized to (and no amount shall be includible in the income of) such shareholder or security holder on the receipt of such stock or securities" (App. vi).

missioner's own rulings, and with the determination of the deficiency proposed against taxpayers based on such rulings. Petitioner makes essentially the same contention, properly rejected by the Tax Court (I-R. 117-118), that the subject of the distribution by Pacific to its shareholders under the plan of reorganization was the rights to subscribe to the Northwest stock, rather than the Northwest stock itself. Petitioner asserts that taxpayers "realized a 'profit' on the distribution of the rights, which is taxable as a dividend, absent a specific statutory exemption" (Pet. Br. 8). Again, petitioner alleges that Pacific "distributed" rights which set a purchase price for the Northwest stock below the fair market value of the stock, and thereby reflected an intention to distribute corporate earnings which, absent an exemption provision, would be fully taxable as a dividend (Pet. Br. 15, 16). The exercise of the rights is considered by petitioner as merely determining the *time* when dividend income in the form of rights was received, and the *amount* of such dividend income (Pet. Br. 16).

This analysis is not only directly contrary to the Commissioner's own rulings and determination which he made in this case, but is completely contrary to the Supreme Court decision in *Palmer v. Commissioner* (1937) 302 U.S. 63, relied on by the Tax Court. The Commissioner ruled (I-R. 106) that no taxable income would result from the receipt of rights by Pacific shareholders to purchase Northwest stock, even though the fair market value of the Northwest stock at the time of issuance of the rights[7]

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[7]The term "issuance" rather than "distribution" is considered to be more accurate here, since these rights were created by Pacific.

might be in excess of the offering price. Additionally, he ruled that if the rights were held until the date of expiration of the rights, without having been exercised, sold or exchanged, no taxable income would result. The Commissioner further ruled that when rights were exercised by Pacific shareholders, and at the time of exercise the fair market value of the Northwest stock was in excess of the offering price, a distribution of property to such shareholders, in the form of Northwest stock, would occur at that time, taxable under section 301 (App. i-iii) (I-R. 106).

In the case of individual shareholders, the Commissioner ruled that the amount of the dividend distribution would be the difference between the fair market value of the Northwest stock at the time of exercise and the $16 per share offering price. In the case of corporate shareholders, the Commissioner ruled, in substance, that there would be no dividend distribution if the basis of the Northwest stock in the hands of Pacific was less than $16 per share. The latter ruling was based on the provisions of section 301(b) (I-R. 106). The deficiency notice in this case follows these rulings (I-R. 20).[8]

The Commissioner further ruled as follows: "Section 355 of the Code will not be applicable to the receipt by the shareholders of the Pacific Company of stock of the Northwest Company upon exercise of the above-described rights" (Exh. 67-000, p. 6). Taxpayers are in accord with the Commissioner's rulings referred to as to the nature of the rights issued by Pacific, and that a distribution in the

[8]See Income Tax Regulations section 1.301-1(j), and *Timberlake v. Commissioner of Internal Revenue* (4 Cir. 1942) 132 F.2d 259, cited by petitioner (Pet. Br. 15).

form of Northwest stock occurred upon the exercise of said rights. Taxpayers disagree, however, with the Commissioner's ruling that section 355 of the Code does not apply to this distribution. If section 355 applies, then section 301 cannot apply to the distribution of the Northwest stock, as conceded by petitioner (Pet. Br. 16). Taxpayers contend that section 355 applies to the distribution of the Northwest stock, and not section 301. This is the primary issue in this case.

In making his advance rulings on the tax treatment of the Northwest rights and holding that exercise of the rights resulted in a distribution of the Northwest stock, the Commissioner followed the decision of the Supreme Court in *Palmer v. Commissioner* (1937) 302 U.S. 63. In the *Palmer* case the Supreme Court considered the question of whether shareholders of a corporation received dividend income when they exercised rights issued to them to purchase the stock of a corporation which was owned by the distributing corporation.[9] At the time the distributing corporation there involved set the purchase price provided for in the rights, the fair market value of the stock subject to these rights and the purchase price provided for therein were substantially the same. However, when the rights were issued to the shareholders, and when they were later exercised by them, the value of the stock was in excess of the purchase price. One of the principal questions considered in the *Palmer* case was whether the issuance of the rights constituted a distribution of a dividend, as the Commissioner had there determined.

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[9]The *Palmer* case did not deal with a spinoff situation such as is involved in this case.

The Court, in language which is unmistakable, held:

> "*First.* The mere issue of rights to subscribe and their receipt by stockholders, is not a dividend. No distribution of corporate assets or diminution of the net worth of the corporation results in any practical sense. Even though the rights have a market or exchange value, they are not dividends within the statutory definition. Cf. *Miles v. Safe Deposit & T. Co.*, 259 U.S. 247; *Helvering v. San Joaquin Co.*, 297 U.S. 496; *Helvering v. Bartlett*,[10] *supra.* They are at most options or continuing offers, potential sources of income to the stockholders through sale or the exercise of the rights. Taxable income might result from their sale, but distribution of the corporate property could take place only on their exercise. The question, then, is whether the distribution which results from the exercise of the rights must be regarded as a dividend * * *" (302 U.S. 71).

Petitioner's seeming notion in the case at bar that there was a "profit" realized from the disposition of the rights (Pet. Br. 8, 16) simply will not square with the decision of the Supreme Court in the *Palmer* case. As the Supreme Court made crystal clear, the rights issued by Pacific to its shareholders were not dividends, but merely *offers* to them to purchase Northwest stock. The sole purpose and effect of the rights, which expired by their terms after about three weeks, was to act as a vehicle for the transfer of the Northwest stock to the Pacific shareholders, conditioned upon the payment of cash. The issuance of the

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[10]In *Bartlett* (71 F.2d 598) the court held that when rights were exercised they were extinguished and merged into the stock purchased in exercise of the rights.

rights by Pacific did not effect any distribution of property by Pacific to its shareholders. A distribution of Pacific's property could take place only on exercise of the rights. On such exercise, the rights were extinguished, and the property distributed by Pacific to its shareholders consisted of Northwest stock. It is the Northwest stock that the Commissioner has determined to be the subject of the distribution as a taxable dividend, both in his rulings and in the determination of the deficiency in this case.

The Tax Court properly applied the *Palmer* case, and held that the issuance of rights in this case may not be considered as a distribution of corporate earnings and profits. The Tax Court stated as follows (I-R. 118):

> "If any income is to be charged to [taxpayers] it must be regarded as stemming from the exercise of the rights, by obtaining the Northwest stock for a consideration less than its fair market value. But Section 355 was intended to permit the receipt of such stock without tax even where the recipient paid nothing therefor, and we think it would be a distortion of Congressional purpose to impute an intention to impose the tax where the recipient was required in effect to contribute to the capital of the distributing corporation as a condition to receiving the distributed stock."

The Tax Court carefully considered all of the conditions prescribed in section 355 and found that they were fully satisfied. It further held, pursuant to section 355, that no gain or includible income must be recognized in respect of the Northwest stock received by taxpayers, and therefore, that the Commissioner erred in determining that

taxpayers received any dividend income. The Tax Court found it unnecessary to pass on the alternative contentions made by taxpayers that they received no dividend income by reason of other sections of Subchapter C of the Code (I-R. 111).

It remains only to examine the specific objections raised by petitioner that various requirements of section 355 have not been met. These objections are set out in headings C, D, E and F of petitioner's brief on pages 19 through 30, inclusive. Taxpayers will discuss these objections in the order in which they are set forth in petitioner's brief, and demonstrate that they are without merit.

A. Pacific "distributed" Northwest stock to taxpayers "with respect to its stock," as required by section 355(a)(1)(A).

In contending that the conditions of section 355(a)(1)(A) (App. v) are not met, petitioner focuses on certain words and phrases in that subsection. The essence of petitioner's contentions in this regard is set out as follows (Pet. Br. 20):

> "In this case, Pacific did not 'distribute' Northwest stock 'with respect to its stock.' Rather, it sold Northwest stock having a market value of $26 for six stock rights and $16. The only thing Pacific distributed 'with respect to its stock' were stock rights, and such rights are not 'stock or securities,' but only options to purchase stock."

These assertions are a restatement of petitioner's erroneous theory that the subject of the distribution here in question was the stock rights rather than the Northwest

stock received by taxpayers on the exercise of their rights.[11]

In making his contentions under section 355(a)(1)(A), petitioner purports to give that language a literal reading by making a distinction between a "distribution" and what petitioner terms a "sale." The Tax Court held that the Northwest stock was "literally distributed" to petitioners (I-R. 117). Petitioner finds this statement of the court "astonishing" and "completely unfounded" (Pet. Br. 20). On the contrary, the Tax Court's conclusion is squarely in accord with the decision of the Supreme Court in the *Palmer* case. There, the Supreme Court stated as follows (302 U.S. 69):

> "*While a sale of corporate assets to stockholders is, in a literal sense, a distribution of its property,* such a transaction does not necessarily fall within the statutory definition of a dividend. For a sale to stockholders may not result in diminution of its net worth and in that case cannot result in any distribution of its profits" (emphasis added).

Not only is petitioner in error in asserting that the term "distribution" precludes a transfer for a consideration, but it may clearly embrace, as the Supreme Court has said in the *Palmer* case, a transfer for a cash consideration, i.e., what petitioner refers to as a sale. The Tax Court thus correctly held that there was literally a distribution of the Northwest stock. This conclusion, as has

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[11]As the Tax Court properly noted, if the subject of the distribution was the Northwest stock rather than the rights, it is unnecessary to consider whether stock rights constitute securities within the meaning of section 355(a)(1)(A) (I-R. 116, n. 7).

been noted above, is in accordance with the Commissioner's own ruling.

Petitioner next contends that whatever meaning may be attached to the word "distribute," standing alone or in a different context, the phrase "distribution with respect to stock" is always used to refer to distributions *without* consideration, not sales (Pet. Br. 21). First of all should be noted the contradiction between this contention and the petitioner's determination of the deficiency in this case. Petitioner has determined that the taxpayers received a distribution from Pacific which is taxable as a dividend under section 301 (App. i-iii). How can it be said that taxpayers received a distribution taxable as a dividend and not, as petitioner asserts, a distribution with respect to their Pacific stock? There can be no dividend income except "with respect to stock," since only a stockholder can receive a distribution taxable as a dividend under section 301. As the owners of 600 shares of common stock of Pacific, taxpayers received 600 rights. As shareholders of Pacific, they exercised all of said rights, and thereby received shares of Northwest stock. To state, as petitioner contends, that taxpayers at one and the same time received a distribution which is taxable as a dividend, and did not receive such distribution with respect to their Pacific stock, is a self-contradiction.

Petitioner attempts to resolve the above contradiction by stating that a dividend is not limited to distributions with respect to stock, but may include transactions other than a distribution with respect to stock (Pet. Br. 21, n. 6). No authority is cited for this startling proposition other than a reference to section 316, which sets forth

the definition of a dividend. It is apparent that this section must be read in conjunction with section 301 (App. i-iii), which expressly provides that a taxable dividend thereunder is a distribution ''made by a corporation to a shareholder with respect to its stock'' (sec. 301(a); see sec. 301(c)(1)). In determining that the taxpayers received taxable dividend income under section 301, the Commissioner necessarily has determined that taxpayers received the Northwest stock with respect to their Pacific stock.

The context of section 355 reveals that the term ''distributes . . . with respect to stock'' was intended to be used in its broadest sense. The term ''distributes'' appears under (i) of section 355(a)(1)(A) (App. v), and likewise under (ii) of that section. As used in (ii), the term ''distributes'' clearly refers to transfers by a corporation for a consideration, for it obviously contemplates exchanges by the distributing corporation of stock or securities of the controlled corporation for its own securities, i.e., its obligations. There is nothing to suggest that the term ''distributes'' under (i) has a more limited meaning and refers to transfers of corporate property to shareholders without consideration.

Section 355 contemplates and expressly provides for distributions with or without surrender of stock by shareholders, and whether or not pro rata for all of the shareholders (sec. 355(a)(2) (App. vii)). Thus, a transfer of stock of a controlled corporation to preferred stockholders in exchange for their preferred stock could clearly qualify under section 355(a)(1)(A)(i) as a distribution by a

corporation to a shareholder with respect to its stock. It is apparent that distributions with respect to stock necessarily include distributions for a consideration.

Petitioner asserts, however, that wherever this phrase is used in the Code, it never means distributions for a *cash* consideration (Pet. Br. 20-21). On the contrary, the Commissioner's own regulations at section 1.301-1(j) and (k) (App. xiii-xiv) provide that a transfer of property by a corporation to its shareholders in exchange for cash can involve a distribution of property with respect to its stock, and can result in a dividend unless one of the non-recognition provisions of the Code applies. The regulations referred to deal with so-called bargain purchases of corporate property by a shareholder. Under these regulations, an individual shareholder who is permitted to purchase corporate property for less than its fair market value is considered to have received a taxable distribution equal to the bargain element in his purchase. This is the theory on which the Commissioner has relied in holding that the purchase by taxpayers of the Northwest stock for less than its fair market value resulted in the distribution of a taxable dividend. The court below properly ruled that there was a distribution with respect to the Pacific stock, but that section 355 applied to this distribution, so that no taxable income resulted therefrom.

Petitioner adverts to the use of the term "solely" in section 355(a)(1)(A) and asserts that the "sole consideration permitted by section 355 is an exchange of stock or securities" (Pet. Br. 21). This statement would be correct if petitioner had stated that the sole considera-

tion *permitted to be received tax free* by section 355 is stock or securities. Section 355 like other comparable nonrecognition provisions in this part of the Code does not preclude the *payment* of cash by a tax-free distributee. This is manifest when section 355 is examined in relation to its companion sections 354 and 356 (App. iv-v, ix-xii). Section 356 provides that where tax-free distributions or exchanges under sections 354 or 355 involve the receipt of stock or securities permitted to be received without the recognition of gain, and *also* of other property or money, gain is to be recognized to the extent of the money or such other property *received.* The authorities are too numerous to cite that where, under section 354 and its pedecessor sections, the recipient of stock or securities *paid* money, nonrecognition of gain would still remain for the stock or securities received (e.g., *Securities Co. v. Commissioner of Internal Revenue* (2 Cir. 1933) 64 F.2d 330; *Robert Dollar Co.* (1952) 18 T.C. 444, acquiescence). The same is true with respect to the parallel provisions of section 355. Under that section where only stock or securities have been received, with cash *paid,* so too the statute expressly permits the stock or securities to be received without the recognition of gain.

In situations where section 355 would apply but for the receipt of cash or other property, the manifest intent of Congress was to limit the recognition of gain to the amount of such cash or other property *received* (sec. 356). It is inconceivable that Congress could have intended, in a transaction whereunder the Pacific shareholders received Northwest stock and paid money to Pacific, that such payment should occasion a tax on the receipt of their

Northwest stock. The purpose of the offering of the Northwest stock to the Pacific shareholders was to permit them on the exercise of their rights to have the same ownership of Northwest after such exercise as they had in the business and properties transferred by Pacific to Northwest before the plan for reorganization was carried out. After the taxpayers exercised the rights issued to them, they owned precisely the same equity interest in the business and property of Pacific and Northwest as they had in Pacific before the plan was carried out. In addition, taxpayers paid into Pacific in cash $16 for each and every share of Northwest received by them.

As petitioner's brief states, it is beyond argument that the fundamental basis of nonrecognition of gain or loss under section 355 is that no tax should be imposed when the same people continue to own the same businesses with only formal changes in the business organization (Pet. Br. 24). This is precisely what occurred here. There was a readjustment of corporate ownership involving the division of the assets and businesses of Pacific between those in California and those in the States of Oregon, Washington and Idaho. Such readjustments were intended by Congress to be permitted under section 355 as long as the interests of the shareholders remained in corporate solution. In the division of the assets and businesses of Pacific through the plan of reorganization, taxpayers received nothing other than the Northwest stock. Section 355 literally requires that the receipt of this stock be treated as tax free. Certainly it would take the most positive language in section 355 to impose a tax merely because cash had been paid in by the shareholders of Pacific, when

admittedly without such payment section 355 would have permitted them to receive the Northwest stock tax free. No such language and no such intent can be found in section 355.

B. Distribution by Pacific of all of the stock of Northwest satisfied the transfer of control requirement of section 355(a)(1)(D).

Petitioner asserts that the provisions of section 355(a)(1)(D) (App. vi) are not satisfied, since Pacific did not distribute, with respect to its stock, control of Northwest. Control is defined as the ownership of at least 80 per cent of the voting stock and 80 per cent of all other stock of the corporation (Pet. Br. 23). Under this portion of his argument, petitioner reserves for later discussion the point that 57 per cent of the stock of Northwest was transferred in 1961, and the remainder transferred in 1963. As petitioner states, this argument is a mere restatement of his contentions discussed by taxpayers under heading A of this brief (Pet. Br. 23). It reflects petitioner's groping for a rationalization of his position that Congress intended to preclude the application of section 355 in a situation where stock of a controlled corporation is transferred to shareholders who paid cash into the distributing corporation.

Petitioner asserts that "the issuance of transferable stock rights, the exercise of which requires substantial cash payments by the shareholders, predictably will diminish the continuity of ownership" (Pet. Br. 24). It should be noted first that there was no substantial diminution of continuity of ownership present here. When the plan of reorganization was completed more than 95

per cent of the stock of Northwest was owned by the same Pacific shareholders to whom the rights to acquire Northwest stock were distributed (I-R. 125, n. 10). Petitioner alleges that section 355 was designed to minimize the risk that shareholders of a distributing corporation would receive shares of a controlled corporation which they might turn around and sell, and thereby privately "cash in" on the distributing corporation's earnings and profits (Pet. Br. 24). But the provisions designed to prevent this method of tax avoidance are contained in an entirely different subsection of section 355, namely, section 355(a)(1)(B) (App. vi). Section 355(a)(1)(B) provides that the transaction involving a distribution of the stock of a controlled corporation may not be used as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation, or both. Congress expressly recognized that, subsequent to the distribution, the stock of the controlled corporation might be sold or exchanged by all or some of the distributees. It was expressly provided that such fact alone should not be construed to mean the transaction was principally used as such a device (sec. 355(a)(1)(B)). No question of such a "device" is present here. It is undisputed that the plan of reorganization and the transfer of the Northwest stock to the Pacific shareholders fulfilled sound business purposes of Pacific, and were not in any way intended or used as a device for the distribution of earnings and profits.

With respect to section 355(a)(1)(D), Congress plainly required that there be continuity of interest as between the shareholders or security holders of the distributing

corporation and the controlled corporation, but this was required only to the extent of 80 per cent of the stock of the controlled corporation. Here, there was continuity of interest represented by 95 per cent of the stock of Northwest. There is thus present the fundamental basis for nonrecognition of gain or loss under section 355 which petitioner espouses (Pet. Br. 24). Petitioner states that the fundamental basis for nonrecognition under that section "is that no tax should be imposed when the same people continue to own the same businesses with only formal changes in the business organization." No more inappropriate occasion for recognition of a gain could be found than here, where taxpayers exercised their rights and acquired Northwest stock to maintain precisely the same corporate interest after the reorganization as they possessed before. Far from *receiving* any benefit in the form of cash or other property, which might provide an appropriate occasion for the imposition of a tax, taxpayers *paid out* money.

As the Tax Court pointed out, Pacific disposed of every share of Northwest, retaining none whatever, thereby satisfying the underlying objective of section 355(a)(1)(D) (I-R. 124-125). The court further noted that the fact that some shares were transferred to purchasers of rights, rather than to stockholders, was immaterial, for in any event more than 80 per cent of the shares of Northwest were transferred to Pacific shareholders. Section 355(a)(1)(D) was therefore fully satisfied.

C. Section 355(a)(1)(D) does not require a single distribution of control of Northwest, as petitioner contends.

Petitioner contends that the requirement of section 355(a)(1)(D) (App. vi) relating to the distribution of all or at least 80 per cent of the stock of Northwest is not satisfied (Pet. Br. 25-27). His position in this regard is variously stated as follows: (1) that section 355(a)(1)(D) requires "a single distribution" (Pet. Br. 25); (2) that "the date of distribution is a pivotal moment in time" (Pet. Br. 26); and (3) that the single distribution must occur "at a fixed point in time" (Pet. Br. 27). Petitioner asserts that any other interpretation of section 355(a)(1)(D) would make its operation "administratively unworkable" (Pet. Br. 25).

At the outset it should be observed, as petitioner admits, that this argument is made for the first time on review by this Court (Pet. Br. 26, n. 8). Ignoring any question as to whether petitioner is precluded from urging this contention before this Court, it must clearly be rejected as without merit. Petitioner's reliance is on a purported literal reading of the statute involving isolated words and phrases in section 355 and attributing to them a meaning without regard to their context. Petitioner seizes on the use of the singular in referring to "the date of distribution," and insists that the use of the phrases "immediately before" and "immediately after" a distribution requires a single transfer of control in the distribution of the stock of the controlled corporation at a fixed point in time (Pet. Br. 25-26).

Petitioner can derive no comfort from the use of the singular in the statutory reference to "the distribution"

or "the date of distribution." The statute likewise refers to "a shareholder" in section 355(a)(1)(A)(i) (App. v), and certainly it would be inconceivable that the use of the singular therein required that its operative effect be limited to transactions involving a single shareholder. The short answer to all of this is that section 1 of Title 1 of the United States Code provides that, unless the context indicates otherwise, words importing the singular include and apply to the plural. Nothing in the context of section 355 requires a fixing of a single date for the distribution of control.

Petitioner seeks to support his argument by references to the language "immediately before" and "immediately after" as connoting a requirement for a single transfer. This language was obviously borrowed from and parallels the language "immediately after" in section 351 (App. iii-iv) and its predecessor provisions. The language of section 351 has been uniformly considered to admit of a number of transfers. Section 351 has never been considered as requiring a single transfer (*Halliburton v. Commissioner of Internal Revenue* (9 Cir. 1935) 78 F.2d 265; *Portland Oil Co. v. Commissioner of Internal Revenue* (1 Cir. 1940) 109 F.2d 479, certiorari denied (1940) 310 U.S. 650). The Treasury regulations interpreting section 351, which have been substantially unchanged since the regulations under the Revenue Act of 1934, provide as follows:

> "The phrase 'immediately after the exchange' does not necessarily require simultaneous exchanges by two or more persons, but comprehends a situation where the rights of the parties have been previously defined and the execution of the agreement proceeds

with an expedition consistent with orderly procedure" (Income Tax Regs. sec. 1.351-1(a)(1)).

Far from supporting the novel position adopted by the petitioner, the use of this language clearly requires rejection of petitioner's contention.

Section 355 is a part of the subchapter of the Code which deals with corporate reorganizations. In fact, transactions to which section 355 is applicable may well involve reorganizations under section 368. Section 355(a)(2)(C) (App. vii) provides that section 355 may be applied whether or not the distribution is in pursuance of a plan of reorganization under section 368. Section 355 was intended to deal in one section with the subject matter of corporate reorganizations in the form of spinoffs, split-offs and split-ups (S.Rept. 1622, 83d Cong., 2d Sess., 266). Congress was well aware of the operation of the reorganization provisions contained in Subchapter C. These provisions have long been construed so as to permit the treatment of various steps in consummating plans of reorganization as part of a single transaction (3 Mertens, Law of Federal Income Taxation, sec. 20.161 et seq., and cases there cited). The Commissioner himself has ruled that the step transaction doctrine, generally applicable in the case of reorganizations under section 368, applies under section 355 (Rev. Rul. 57-311, C.B. 1957-2, 243).

Not only is there no basis in the language of section 355 to support the contention that the distribution of control required under section 355(a)(1)(D) must be effected on or as of a single day, but there is no warrant for the assertion that any other construction would make

the statute administratively unworkable. On the contrary, the strained manner in which petitioner seeks to limit the operation of section 355 would make it virtually unworkable for corporations having a large number of shareholders. This may be illustrated by what transpired in carrying out the plan of reorganization by Pacific. Pacific had over 38,000 shareholders. Its stock was listed on the New York Stock Exchange and the Pacific Coast Stock Exchange. The Northwest stock was listed on the American Stock Exchange and on the Pacific Coast Stock Exchange. The consummation of the plan of reorganization of Pacific was quite complex. It involved the formulation of the plan, its presentation to the directors and shareholders, approvals by state and Federal regulatory agencies, the filing of registration statements with the Securities and Exchange Commission, the listing of securities on the various Exchanges, and the complicated corporate and financial matters involved in the issuance of the very large amounts of stock of Northwest and the receipt of large amounts of capital. When these transactions were completed, Pacific distributed 30,460,000 shares of Northwest and received $487,360,000.

It is undisputed that the transactions involving the initial distribution of the Northwest stock in 1961 and the distribution of the Northwest stock in 1963 were interrelated, interdependent and justifiably occurring within the period of two years as contemplated by the plan (Pet. Br. 25-26). Petitioner finds it difficult to comprehend that ''the state of mind of those in control of the distributing corporation should have the effect of transforming two distributions into one'' (Pet. Br. 26). It is

not merely an intent that is controlling in requiring that the two transfers of the Northwest stock be viewed as parts of a single transaction, but rather the fact that they were contemplated and required by the plan of reorganization pursuant to which the Northwest shares were distributed. It is submitted that unless corporations could have some leeway in the timing of exchanges and distributions of stock or securities of a controlled corporation under section 355, that section would be virtually useless in carrying out readjustments of corporate and stockholder relationships as contemplated by section 355 in the case of corporations of any magnitude. It should be noted that section 355 embraces distributions not only to shareholders but also to all other security holders and also prorata or non-prorata distributions and exchanges, with or without the surrender of stock. It is inconceivable that, with such latitude allowed corporations in the manner of effecting corporate readjustments under section 355, Congress would have required that they take place as of a single day. No rational basis can be found for any such limitation. None is expressed in any of the committee reports dealing with section 355.

Under the reorganization provisions elsewhere in Subchapter C, in which section 355 appears, tax-free reorganization plans have been allowed to be carried out over a period of time. Such time intervals in effecting tax-free reorganizations have not involved any unworkable administrative difficulties that petitioner professes to see if several distributions were treated under section 355 as part of a single transaction. There is present here no administrative difficulty in determining that the require-

ments of section 355(a)(1)(D) are fully satisfied, as held by the Tax Court. Both immediately before and immediately after the distributions, both Pacific and Northwest were engaged in active businesses (sec. 355(b)(1)(A)). The business of Northwest had been conducted for a period of five years ending on the date of distribution (sec. 355(b)(2)(B)). Obviously, the business of Northwest, like that of Pacific, was actively continued both long before and long after the plan of reorganization was begun and completed. The Tax Court properly held that the disposition by Pacific of every share of Northwest, retaining none whatever, carried out the underlying objective of section 355(a)(1)(D) (I-R. 124-125).

D. When Northwest acquired its telephone businesses from Pacific in exchange for stock and a demand note, no gain was recognized in whole or in part within the meaning of section 355(b)(2)(C).

The last objection made by the petitioner to the application of section 355 to the transactions here in question involves section 355(b)(2)(C) (App. ix). That section imposes a limitation on the acquisition by the controlled corporation of the business which is the subject of the section 355 distribution. The limitation here in question, which petitioner contends is not satisfied, is that the business of the controlled corporation *not* be acquired in a transaction "in which gain or loss was recognized, in whole or in part." This restriction is related to the so-called five-year active business rule, and requires that an active business be conducted for a period of five years either by the controlled corporation, Northwest, or by its predecessor corporation, Pacific. If the latter, the business must

have been transferred from Pacific to Northwest in a tax-free transaction.

The burden of petitioner's argument is that the telephone businesses in the States of Washington, Oregon and Idaho were acquired by Northwest in a transaction to which section 351 (App. iii-iv) applies, and, that under said section, gain would have been required to be recognized by Pacific in part, to the extent of the $200 million demand note received by Pacific. Petitioner contends that the $200 million note received by Pacific from Northwest was not a security within the meaning of section 351, which could have been received by Pacific tax free (Pet. Br. 28).

The Tax Court found it unnecessary to determine whether or not the demand note was a security for purposes of section 351 (I-R. 121). The Tax Court held that the nonrecognition requirements of section 355(b)(2)(C) were satisfied by reason of the fact that the transfer by Pacific of the assets to Northwest was an intercompany transaction between affiliated corporations included in the consolidated income tax return filed by American, and that therefore no taxable gain resulted therefrom (I-R. 121). Petitioner does not dispute that whatever gain Pacific might have had on the transfer of the assets to Northwest was properly eliminated and not taxable under the consolidated return provisions and regulations thereunder (Pet. Br. 29). Petitioner insists, however, that a distinction must be made between nonrecognition of gain by reason of the filing of a consolidated income tax return and nonrecognition of gain under provisions of Subchapter C, and contends that only the latter type of

nonrecognition satisfies the requirement of section 355 (b)(2)(C) (Pet. Br. 29).

Petitioner states that the Tax Court ''apparently never considered'' what intelligible legislative purpose would be served by making qualification under section 355 depend upon the happenstance that an affiliated group of corporations subsequently elected to file a consolidated income tax return (Pet. Br. 29).

First of all, it should be noted that there was no election made in 1961 for the filing of a consolidated income tax return. Corporations which had filed consolidated income tax returns for 1960 were not permitted to make a new election for 1961 (Income Tax Regs. sec. 1.1502-11). Since American had filed a consolidated income tax return for the year 1960, it was required to, and did, file a consolidated income tax return for the year 1961. This fact alone casts serious doubt upon petitioner's argument that the character of the transaction must for purposes of section 355(b)(2)(C) be examined as of the date on which it occurs, and that a subsequent option may not relate back to change the character of the transaction (Pet. Br. 29-30).

More important, however, is the fact that the Tax Court did set forth a rational basis for its interpretation of the statute, and one which is clearly supported by its legislative history. It should be noted that no rational basis has been urged by petitioner for contending that hypothetical nonrecognition of gain under section 351 will satisfy the statute, but that actual nonrecognition of gain under other provisions of the Code will not. Certainly no

language can be pointed to by petitioner which so limits the nonrecognition provisions of section 355(b)(2)(C).

The purpose of section 355(b)(2)(C) was to provide a further safeguard against the use of section 355 as a means of distributing earnings and profits. As the Tax Court well stated, and as amply demonstrated by the committee reports (S.Rept. 1622, 83d Cong., 2d Sess., pp. 267-268), Congress was concerned that a going business with liquid assets might be purchased for the purpose of providing a medium through which a tax-free distribution of a corporation's earnings and profits could be effected (I-R. 120; see Cohen, Silverman, Surrey, Tarleau and Warren, The Internal Revenue Code of 1954: Corporate Distributions, Organizations, and Reorganizations, 68 Harvard Law Review, 1954-1955, 393, 432). As the Tax Court stated, no such circumstances are present here. This case involves the operation of businesses conducted for many years by Pacific. The legislative purpose of section 355(b)(2)(C) is clearly served by permitting the businesses of Pacific in the States of Oregon, Washington and Idaho to be the subject of a tax-free divisive reorganization.

E. In any event, even if nonrecognition of gain on the transfer of assets to Northwest is required under section 351, the demand note of Northwest was a security permitted to be received tax free by Pacific under that section.

To support his contention that section 355(b)(2)(C) (App. ix) is not complied with, petitioner must be correct in his assertion that the required nonrecognition of gain on the transfer of the assets to Northwest must fall under section 351 (App. iii-iv) or some other section of Sub-

chapter C, and may not come under the consolidated return provisions. In addition, petitioner must demonstrate that gain would have been recognized to Pacific on such transfer under section 351. Petitioner claims that such a hypothetical gain would have resulted under section 351 because of the receipt of the $200 million demand note by Pacific as part of the consideration for the transfer of the assets and business to Northwest.

Petitioner asserts that the $200 million demand note was not a security within the meaning of section 351(a) (App. iii-iv), which could have been received tax free by Pacific under section 351. The statement is made that corporate notes qualify as securities ''only when they are of sufficient duration to represent a substantial continuing interest in the corporation'' (Pet. Br. 28, n. 9). This test is, of course, addressed to the character of the corporate indebtedness. Its application does not require that Pacific continue to own the note indefinitely. Rather, the test is whether the indebtedness of Northwest evidenced by the demand note represented part of its permanent capital—as petitioner puts it, ''a substantial continuing interest in Northwest.'' The fact that the debt was in form payable on demand is not controlling. The cases clearly establish that the mere form of indebtedness does not control its status for tax purposes. This is clear from the cases involving so-called ''thin corporations'' where open account indebtedness or short-term notes may be treated as stock (*Gilbert v. C.I.R.* (2 Cir. 1959) 262 F.2d 512, cert. den. (1959) 359 U.S. 1002 (on appeal from remand of (2 Cir. 1957) 248 F.2d 399); *O. H. Kruse Grain & Milling v. C.I.R.* (9 Cir. 1960) 279 F.2d 123).

Here, the facts show that the $200 million indebtedness, evidenced by the demand note received by Pacific, represented part of the permanent capital of Northwest (Exh. 17-Q, pp. 10, 12). The Tax Court found that this indebtedness was included in the liabilities of Northwest when Northwest was organized and was designed to establish Northwest with the same proportions of total debt and stock as those of Pacific prior to the transfer (I-R. 97). If Northwest had included the amount of the $200 million note in the indebtedness of Pacific assumed by Northwest, clearly no gain would have been recognizable to Pacific under section 351. Had Pacific received long-term debentures from Northwest in the same amount as the demand note and had Pacific sold these debentures to the public, likewise, no gain would have been recognized to Pacific under section 351 on the receipt of such long-term debentures from Northwest. The same result should follow here where there was no intention or expectation that Northwest would reduce its capital on the payment of the note held by Pacific. Northwest and Pacific contemplated, as was done, that Northwest would refund the demand note by the issuance of long-term debentures. For this purpose Northwest issued to the public 20-year debentures in the amounts of $50 million each during the period from 1961 to 1963, the proceeds of which were used in payment of the demand note held by Pacific (I-R. 63).

On these facts, it should be held that the demand note was part of the permanent capital of Northwest, and therefore constitutes a security within the meaning of section 351. If this point must be resolved in order to de-

cide this case, and this Court should for any reason feel that the findings of the Tax Court are not sufficient to require the treatment of the demand note as a security within the provisions of section 351, then the case should be remanded by this Court to the Tax Court for specific findings as to whether or not the demand note constituted a security (*Turner Construction Company v. United States* (2 Cir. 1966) 364 F.2d 525). The Tax Court, as has been pointed out, found it unnecessary to so determine, and should be given an opportunity to do so, if a decision on this point is necessary to decide this case.

II

IF FOR ANY REASON THIS COURT SHOULD HOLD THAT SECTION 355 IS NOT APPLICABLE TO THE FACTS OF THIS CASE, THIS CASE SHOULD BE REMANDED TO THE TAX COURT FOR CONSIDERATION OF THE ALTERNATIVE CONTENTIONS OF TAXPAYERS THAT THE COMMISSIONER'S DETERMINATION IS ERRONEOUS.

In addition to contending that section 355 applied to preclude the treatment of the receipt by taxpayers of the Northwest stock as a taxable dividend, taxpayers in the Tax Court relied on other provisions of the 1954 Code. Taxpayers in the court below contended, in the alternative, that no gain should be recognized by taxpayers on the receipt of the Northwest stock by reason of the provisions of section 354, involving exchanges of stock and securities in reorganizations. A further alternative contention made by taxpayers was that if any gain is to be recognized on the receipt of the Northwest stock by taxpayers, such gain must be treated as a capital gain by reason of the

provisions of section 346(b), dealing with distributions in partial liquidation (I-R. 110-111).

If this Court should for any reason hold that section 355 is not applicable and that the receipt of the Northwest stock was not tax free thereby, the case should be remanded for consideration by the Tax Court of these alternative contentions of the taxpayers based on the other provisions of the Code (Pet. Br. 30).

SUMMARY OF ARGUMENT

For sound corporate business reasons, Pacific formulated a plan for the separation of the business and assets of Pacific in the three States of Washington, Oregon and Idaho into a new corporation, Northwest, to have a separate management and to be owned by the Pacific shareholders. Pacific was advised by its attorneys that it was not possible under the California corporation law to distribute the stock of Northwest to its shareholders pro rata out of its capital or surplus. Petitioner concedes that had Pacific transferred its assets, in the three states referred to, to Northwest for its common stock and had it distributed such stock to its shareholders, there would have occurred, in the language of the Tax Court, "a classic case of a tax-free divisive reorganization," or spinoff, to which section 355 (App. v-ix) was clearly addressed. The only factor present here not present in the classic tax-free spinoff case was that the distribution of the Northwest stock was conditioned upon payment of $16 a share by Pacific shareholders to Pacific. Such cash pay-

ment served the additional purpose of providing needed capital for Pacific's operations in California. If section 355 applies to the receipt of the Northwest stock by taxpayers, petitioner concedes that no amount is includible in their income on the receipt of the Northwest stock.

Petitioner's contentions that section 355 does not apply revolve around a basic misconception of the proper tax treatment of the rights issued by Pacific to its shareholders. Petitioner contends that the subject of the distribution by Pacific to its shareholders under the plan of reorganization was the rights to subscribe to the Northwest stock, rather than the Northwest stock itself. The Tax Court properly held, in accordance with the Supreme Court's decision in *Palmer v. Commissioner* (1937) 302 U.S. 63, that the subject of the distribution by Pacific was not the rights but the Northwest stock. The court in the *Palmer* case held that the mere issuance of rights does not involve a distribution of corporate assets, since rights are options or continuing offers which result in distribution of the corporate property only on their exercise. The Tax Court properly held that the Northwest stock was distributed by Pacific and that section 355 applied to this distribution.

Petitioner is in error in his contention that the Northwest stock was not distributed by Pacific to Pacific shareholders, as required by section 355(a)(1)(A) (App. v). The phrase "distributes . . . with respect to stock" does not preclude a transfer for a consideration. It may clearly embrace, as the Supreme Court said in the *Palmer* case, a transfer for a cash consideration. When section 355 is examined in relation to its companion sections 354 and

356 (App. iii-iv, ix-xii), it is clear that gain is to be recognized only to the extent of cash or other property *received,* and not where solely stock or securities have been received, with cash *paid.* There is present here, as petitioner states, the fundamental basis for nonrecognition of gain under section 355, namely, that no tax should be imposed when the same people continue to own the same businesses with only formal changes in the business organization. The Tax Court properly held that the distribution by Pacific of every share of Northwest, retaining none whatever, satisfied the underlying objective of section 355(a)(1)(D). Under this section, Congress plainly required that there be continuity of interest as between the shareholders of the distributing corporation and the controlled corporation only to the extent of 80 per cent of the stock of the controlled corporation. Here, there was continuity of interest represented by 95 per cent of the stock of Northwest.

Petitioner erroneously asserts that section 355(a)(1)(D) (App. vi) requires a single distribution of control of Northwest at a fixed point in time. Section 355 was intended to deal in one section with the subject matter of reorganizations in the form of spinoffs, split-ups and split-offs. The reorganization provisions in Subchapter C have long been construed so as to permit the treatment of various steps in consummating plans of reorganization as part of a single transaction. It is undisputed that the transactions involved in the initial distribution of the Northwest stock in 1961, and the distribution of the Northwest stock in 1963, were interrelated, interdependent and justifiably occurring within the period of two years, as

contemplated by the plan. There are no administrative difficulties in viewing these distributions as part of a single transaction which satisfied the distribution of control requirement in section 355(a)(1)(D).

There is no merit to petitioner's contention that the transfer of the business to Northwest did not satisfy the nonrecognition provisions of section 355(b)(2)(C) (App. ix). No taxable gain in fact resulted because the transfer was an intercompany transaction between affiliated corporations included in a consolidated income tax return filed by American. Petitioner concedes that no taxable gain resulted from the transfer. Petitioner contends, however, that such nonrecognition of gain does not satisfy the requirements of section 355(b)(2)(C), and that the transaction must qualify for nonrecognition under some provision of Subchapter C—in this case, section 351. The Tax Court properly ruled that actual nonrecognition of gain under any provisions of the Code satisfied the provisions of section 355(b)(2)(C). These provisions were designed to prevent the use of section 355 as a means of distributing earnings and profits through the purchase of a going business with liquid assets. No such circumstances are present here. The legislative purpose of section 355(b)(2)(C) is clearly served by permitting the businesses of Pacific in the States of Washington, Oregon and Idaho to be the subject of a tax-free divisive reorganization.

Even if nonrecognition of gain under section 351 is required on the transfer of the assets of Northwest, for purposes of section 355(b)(2)(C), the demand note of Northwest was a security permitted to be received tax

free by Pacific. This note represented a permanent part of Northwest's capital. It was refunded by the public offering by Northwest of 20-year debentures in the amount of $50 million each.

The Tax Court deemed it unnecessary to make specific findings as to whether the $200 million note qualified as a security for purposes of section 351. If this point must be resolved in order to decide this case, and the Court should for any reason feel that the findings of the Tax Court are not sufficient to require that the demand note be treated as a security, then the case should be remanded to the Tax Court for further findings.

Taxpayers have made alternative contentions that no gain or loss was recognized on the receipt of Northwest stock because of the application of section 354, involving exchanges of stock or securities in reorganizations. A further alternative contention was made that if gain was to be recognized to the taxpayers on the receipt of the Northwest stock, such gain should not be treated as dividend income but as capital gain under the provisions of section 346(b), dealing with distributions by corporations in partial liquidation. The Tax Court found it unnecessary to pass on these alternative contentions because it held that the receipt of the Northwest stock was tax free under section 355. If this Court should hold that section 355 is not applicable, the case should be remanded for consideration by the Tax Court of these alternative contentions.

CONCLUSION

For the reasons stated herein, this Court should hold that section 355 applies to the receipt of the Northwest stock by taxpayers, and the decision of the Tax Court should be affirmed. If this Court should hold that section 355 is not applicable, the case should be remanded to the Tax Court for consideration of the alternative contentions of taxpayers based on other provisions of the Code.

Respectfully submitted,

Harry R. Horrow,

Stephen J. Martin,

Attorneys for Respondents.

Pillsbury, Madison & Sutro,

Of Counsel.

November 8, 1966.

Certificate

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: November 8, 1966.

Harry R. Horrow.

(Appendix Follows)

Appendix

Appendix

Internal Revenue Code of 1954:

SEC. 301. DISTRIBUTIONS OF PROPERTY.

(a) In General.—Except as otherwise provided in this chapter, a distribution of property (as defined in section 317 (a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

(b) Amount Distributed.—

(1) General rule.—For purposes of this section, the amount of any distribution shall be—

(A) Noncorporate distributees.—If the shareholder is not a corporation, the amount of money received, plus the fair market value of the other property received.

(B) Corporate distributees.—If the shareholder is a corporation, the amount of money received, plus whichever of the following is the lesser:

(i) the fair market value of the other property received; or

(ii) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the other property received, increased in the amount of gain to the distributing corporation which is recognized under subsection (b) or (c) of section 311, under section 341(f), or under section 1245(a) or 1250(a).

(C) Certain corporate distributees of foreign corporation.—Notwithstanding subparagraph (B), if the shareholder is a corporation and the distributing corporation is a foreign corporation, the amount taken into account with respect to property (other than money) shall be the fair market value of such property; except that if any deduction is allowable under section 245 with respect to such distribution, then the amount taken into account shall be the sum (determined under regulations prescribed by the Secretary or his delegate) of—

(i) the proportion of the adjusted basis of such property (or, if lower, its fair market value) properly attributable to gross income from sources within the United States, and

(ii) the proportion of the fair market value of such property properly attributable to gross income from sources without the United States.

(2) Reduction for liabilities.—The amount of any distribution determined under paragraph (1) shall be reduced (but not below zero) by—

(A) the amount of any liability of the corporation assumed by the shareholder in connection with the distribution, and

(B) the amount of any liability to which the property received by the shareholder is subject immediately before, and immediately after, the distribution.

(3) Determination of fair market value.—For purposes of this section, fair market value shall be determined as of the date of the distribution.

(c) AMOUNT TAXABLE.—In the case of a distribution to which subsection (a) applies—

(1) AMOUNT CONSTITUTING DIVIDEND.—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

(2) AMOUNT APPLIED AGAINST BASIS.—That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.

(3) AMOUNT IN EXCESS OF BASIS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock, shall be treated as gain from the sale or exchange of property.

(B) DISTRIBUTIONS OUT OF INCREASE IN VALUE ACCRUED BEFORE MARCH 1, 1913.—That portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock and to the extent that it is out of increase in value accrued before March 1, 1913, shall be exempt from tax.

* * * * *

SEC. 351. TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.

(a) GENERAL RULE.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange

such person or persons are in control (as defined in section 368(c)) of the corporation. For purposes of this section, stock or securities issued for services shall not be considered as issued in return for property.

(b) RECEIPT OF PROPERTY.—If subsection (a) would apply to an exchange but for the fact that there is received, in addition to the stock or securities permitted to be received under subsection (a), other property or money, then—

(1) gain (if any) to such recipient shall be recognized, but not in excess of—

(A) the amount of money received, plus

(B) the fair market value of such other property received; and

(2) no loss to such recipient shall be recognized.

(c) SPECIAL RULE.—In determining control, for purposes of this section, the fact that any corporate transferor distributes part or all of the stock which it receives in the exchange to its shareholders shall not be taken into account.

* * * * *

SEC. 354. EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS.

(a) GENERAL RULE.—

(1) IN GENERAL.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securi-

ties in such corporation or in another corporation a party to the reorganization.

(2) LIMITATION.—Paragraph (1) shall not apply if—

(A) the principal amount of any such securities received exceeds the principal amount of any such securities surrendered, or

(B) any such securities are received and no such securities are surrendered.

(3) CROSS REFERENCE.—

For treatment of the exchange if any property is received which is not permitted to be received under this subsection (including an excess principal amount of securities received over securities surrendered), see section 356.

* * * * *

SEC. 355. DISTRIBUTION OF STOCK AND SECURITIES OF A CONTROLLED CORPORATION.

(a) EFFECT ON DISTRIBUTEES.—

(1) GENERAL RULE.—If—

(A) a corporation (referred to in this section as the "distributing corporation")—

(i) distributes to a shareholder, with respect to its stock, or

(ii) distributes to a security holder, in exchange for its securities, solely stock or securities of a corporation (referred to in this section as "controlled corporation") which it controls immediately before the distribution,

(B) the transaction was not used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (but the mere fact that subsequent to the distribution stock or securities in one or more of such corporations are sold or exchanged by all or some of the distributees (other than pursuant to an arrangement negotiated or agreed upon prior to such distribution) shall not be construed to mean that the transaction was used principally as such a device),

(C) the requirements of subsection (b) (relating to active businesses) are satisfied, and

(D) as part of the distribution, the distributing corporation distributes—

(i) all of the stock and securities in the controlled corporation held by it immediately before the distribution, or

(ii) an amount of stock in the controlled corporation constituting control within the meaning of section 368 (c), and it is established to the satisfaction of the Secretary or his delegate that the retention by the distributing corporation of stock (or stock and securities) in the controlled corporation was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax,

then no gain or loss shall be recognized to (and no amount shall be includible in the income of) such shareholder or security holder on the receipt of such stock or securities.

(2) Non pro rata distributions, etc.—Paragraph (1) shall be applied without regard to the following:

(A) whether or not the distribution is pro rata with respect to all of the shareholders of the distributing corporation,

(B) whether or not the shareholder surrenders stock in the distributing corporation, and

(C) whether or not the distribution is in pursuance of a plan of reorganization (within the meaning of section 368 (a) (1) (D)).

(3) Limitation.—Paragraph (1) shall not apply if—

(A) the principal amount of the securities in the controlled corporation which are received exceeds the principal amount of the securities which are surrendered in connection with such distribution, or

(B) securities in the controlled corporation are received and no securities are surrendered in connection with such distribution.

For purposes of this section (other than paragraph (1) (D) of this subsection) and so much of section 356 as relates to this section, stock of a controlled corporation acquired by the distributing corporation by reason of any transaction which occurs within 5 years of the distribution of such stock and in which gain or loss was recognized in whole or in part, shall not be treated as stock of such controlled corporation, but as other property.

(4) Cross reference.—

For treatment of the distribution if any property is received which is not permitted to be received under this subsection (including an excess principal amount of securities received over securities surrendered), see section 356.

(b) Requirements as to Active Business.—

(1) In general.—Subsection (a) shall apply only if either—

(A) the distributing corporation, and the controlled corporation (or, if stock of more than one controlled corporation is distributed, each of such corporations), is engaged immediately after the distribution in the active conduct of a trade or business, or

(B) immediately before the distribution, the distributing corporation had no assets other than stock or securities in the controlled corporations and each of the controlled corporations is engaged immediately after the distribution in the active conduct of a trade or business.

(2) Definition.—For purposes of paragraph (1), a corporation shall be treated as engaged in the active conduct of a trade or business if and only if—

(A) it is engaged in the active conduct of a trade or business, or substantially all of its assets consist of stock and securities of a corporation controlled by it (immediately after the distribution) which is so engaged,

(B) such trade or business has been actively conducted throughout the 5-year period ending on the date of the distribution,

(C) such trade or business was not acquired within the period described in subparagraph (B) in a transaction in which gain or loss was recognized in whole or in part, and

(D) control of a corporation which (at the time of acquisition of control) was conducting such trade or business—

(i) was not acquired directly (or through one or more corporations) by another corporation within the period described in subparagraph (B), or

(ii) was so acquired by another corporation within such period, but such control was so acquired only by reason of transactions in which gain or loss was not recognized in whole or in part, or only by reason of such transactions combined with acquisitions before the beginning of such period.

SEC. 356. RECEIPT OF ADDITIONAL CONSIDERATION.

(a) Gain on Exchanges.—

(1) Recognition of gain.—If—

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354

or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) Treatment as dividend.—If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property.

(b) Additional Consideration Received in Certain Distributions.—If—

(1) section 355 would apply to a distribution but for the fact that

(2) the property received in the distribution consists not only of property permitted by section 355 to be received without the recognition of gain, but also of other property or money,

then an amount equal to the sum of such money and the fair market value of such other property shall be treated as a distribution of property to which section 301 applies.

(c) Loss.—If—

(1) section 354 would apply to an exchange, or section 355 would apply to an exchange or distribution, but for the fact that

(2) the property received in the exchange or distribution consists not only of property permitted by section 354 or 355 to be received without the recognition of gain or loss, but also of other property or money,

then no loss from the exchange or distribution shall be recognized.

(d) SECURITIES AS OTHER PROPERTY.—For purposes of this section—

(1) IN GENERAL.—Except as provided in paragraph (2), the term "other property" includes securities.

(2) EXCEPTIONS.—

(A) SECURITIES WITH RESPECT TO WHICH NONRECOGNITION OF GAIN WOULD BE PERMITTED.—The term "other property" does not include securities to the extent that, under section 354 or 355, such securities would be permitted to be received without the recognition of gain.

(B) GREATER PRINCIPAL AMOUNT IN SECTION 354 EXCHANGE.—If—

(i) in an exchange described in section 354 (other than subsection (c) thereof), securities of a corporation a party to the reorganization are surrendered and securities of any corporation a party to the reorganization are received, and

(ii) the principal amount of such securities received exceeds the principal amount of such securities surrendered,

then, with respect to such securities received, the term "other property" means only the fair market value of such excess. For purposes of this subparagraph and subparagraph (C), if no securities are surrendered, the excess shall be the entire principal amount of the securities received.

(C) Greater principal amount in section 355 transaction.—If, in an exchange or distribution described in section 355, the principal amount of the securities in the controlled corporation which are received exceeds the principal amount of the securities in the distributing corporation which are surrendered, then, with respect to such securities received, the term "other property" means only the fair market value of such excess.

(e) Exchanges for Section 306 Stock.—Notwithstanding any other provision of this section, to the extent that any of the other property (or money) is received in exchange for section 306 stock, an amount equal to the fair market value of such other property (or the amount of such money) shall be treated as a distribution of property to which section 301 applies.

(f) Transactions Involving Gift or Compensation.—For special rules for a transaction described in section 354, 355, or this section, but which—

(1) results in a gift, see section 2501 and following, or

(2) has the effect of the payment of compensation, see section 61(a)(1).

Income Tax Regulations:

Sec. 1.301-1. Rules applicable with respect to distributions of money and other property.

* * * * *

(j) *Transfers for less than fair market value.* If property is transferred by a corporation to a shareholder which is not a corporation for an amount less than its fair market value in a sale or exchange, such shareholder shall be treated as having received a distribution to which section 301 applies. In such case, the amount of the distribution shall be the difference between the amount paid for the property and its fair market value. If property is transferred in a sale or exchange by a corporation to a shareholder which is a corporation, for an amount less than its fair market value and also less than its adjusted basis, such shareholder shall be treated as having received a distribution to which section 301 applies, and—

(1) Where the fair market value of the property equals or exceeds its adjusted basis in the hands of the distributing corporation the amount of the distribution shall be the excess of the adjusted basis over the amount paid for the property;

(2) Where the fair market value of the property is less than its adjusted basis in the hands of the distributing corporation, the amount of the distribution shall be the excess of such fair market value over the amount paid for the property.

If property is transferred in a sale or exchange after December 31, 1962, by a foreign corporation to a shareholder which is a corporation for an amount less than the

amount which would have been computed under paragraph (n) of this section if such property had been received in a distribution to which section 301 applied, such shareholder shall be treated as having received a distribution to which section 301 applies, and the amount of the distribution shall be the excess of the amount which would have been computed under paragraph (n) of this section with respect to such property over the amount paid for the property. In all cases, the earnings and profits of the distributing corporation shall be decreased by the excess of the basis of the property in the hands of the distributing corporation over the amount received therefor. In computing gain or loss from the subsequent sale of such property, its basis shall be the amount paid for the property increased by the amount of the distribution.

(k) *Application of rule respecting transfers for less than fair market value.* The application of paragraph (j) of this section may be illustrated by the following examples:

Example (1). On January 1, 1955, A, an individual shareholder of Corporation X, purchased property from that corporation for $20. The fair market value of such property was $100, and its basis in the hands of Corporation X was $25. The amount of the distribution determined under section 301(b) is $80. If A were a corporation, the amount of the distribution would be $5, the excess of the basis of the property in the hands of Corporation X over the amount received therefor. The basis of such property to Corporation A would be $25. If the basis of the property in the hands of Corporation X were

$10, the corporate shareholder, A, would not receive a distribution. The basis of such property to Corporation A would be $20. Whether or not A is a corporation, the excess of the amount paid over the basis of the property in the hands of Corporation X ($20 over $10) would be a taxable gain to Corporation X.

Example (2). On January 1, 1963, corporation A, which is a shareholder of corporation B (a foreign corporation engaged in business within the United States), purchased one share of corporation X stock from B for $20. The fair market value of the share was $100, and its adjusted basis in the hands of B was $25. Assume that if the share of corporation X stock had been received by A in a distribution to which section 301 applied, the amount of the distribution under paragraph (n) of this section would have been $55. The amount of the distribution under section 301 is $35, i.e., $55 (amount computed under paragraph (n) of this section) minus $20 (amount paid for the property). The basis of such property to A is $55.

* * * * *

Sec. 1.351-1. Transfer to corporation controlled by transferor.

(a)(1) Section 351(a) provides, in general, for the nonrecognition of gain or loss upon the transfer by one or more persons of property to a corporation solely in exchange for stock or securities in such corporation, if immediately after the exchange, such person or persons are in control of the corporation to which the property was transferred. As used in section 351, the phrase ''one or more persons'' includes individuals, trusts, estates, partnerships, associations, companies, or corporations (see

section 7701(a)(1)). To be in control of the transferee corporation, such person or persons must own immediately after the transfer stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of such corporation (see section 368(c)). In determining control under this section, the fact that any corporate transferor distributes part or all of the stock which it receives in the exchange to its shareholders shall not be taken into account. The phrase "immediately after the exchange" does not necessarily require simultaneous exchanges by two or more persons, but comprehends a situation where the rights of the parties have been previously defined and the execution of the agreement proceeds with an expedition consistent with orderly procedure. For purposes of this section—

(i) stock or securities issued for services rendered or to be rendered to or for the benefit of the issuing corporation will not be treated as having been issued in return for property, and

(ii) stock or securities issued for property which is of relatively small value in comparison to the value of the stock and securities already owned (or to be received for services) by the person who transferred such property, shall not be treated as having been issued in return for property if the primary purpose of the transfer is to qualify under this section the exchanges of property by other persons transferring property. For the purpose of section 351, stock rights or stock warrants are not included in the term "stock or securities."

(2) The application of section 351(a) is illustrated by the following examples:

Example (1). C owns a patent right worth $25,000 and D owns a manufacturing plant worth $75,000. C and D organize the R Corporation with an authorized capital stock of $100,000. C transfers his patent right to the R Corporation for $25,000 of its stock and D transfers his plant to the new corporation for $75,000 of its stock. No gain or loss to C or D is recognized.

Example (2). B owns certain real estate which cost him $50,000 in 1930, but which has a fair market value of $200,000 in 1955. He transfers the property to the N Corporation in 1955 for 78 percent of each class of stock of the corporation having a fair market value of $200,000, the remaining 22 percent of the stock of the corporation having been issued by the corporation in 1940 to other persons for cash. B realized a taxable gain of $150,000 on this transaction.

Example (3). E, an individual, owns property with a basis of $10,000 but which has a fair market value of $18,000. E also had rendered services valued at $2,000 to Corporation F. Corporation F has outstanding 100 shares of common stock all of which are held by G. Corporation F issues 400 shares of its common stock (having a fair market value of $20,000) to E in exchange for his property worth $18,000 and in compensation for the services he has rendered worth $2,000. Since immediately after the transaction, E owns 80 percent of the outstanding stock of Corporation F, no gain is recognized upon the exchange of the property for the stock. However, E realized $2,000

of ordinary income as compensation for services rendered to Corporation F.

(b)(1) Where property is transferred to a corporation by two or more persons in exchange for stock or securities, as described in paragraph (a) of this section, it is not required that the stock and securities received by each be substantially in proportion to his interest in the property immediately prior to the transfer. However, where the stock and securities received are received in disproportion to such interest, the entire transaction will be given tax effect in accordance with its true nature, and in appropriate cases the transaction may be treated as if the stock and securities had first been received in proportion and then some of such stock and securities had been used to make gifts (section 2501 and following), to pay compensation (section 61(a)(1)), or to satisfy obligations of the transferor of any kind.

(2) The application of paragraph (b)(1) of this section may be illustrated as follows:

Example (1). Individuals A and B, father and son, organize a corporation with 100 shares of common stock to which A transfers property worth $8,000 in exchange for 20 shares of stock, and B transfers property worth $2,000 in exchange for 80 shares of stock. No gain or loss will be recognized under section 351. However, if it is determined that A in fact made a gift to B, such gift will be subject to tax under section 2501 and following. Similarly, if B had rendered services to A (such services having no relation to the assets transferred or to the business of the corporation) and the disproportion in the amount of stock

received constituted the payment of compensation by A to B, B will be taxable upon the fair market value of the 60 shares of stock received as compensation for services rendered, and A will realize gain or loss upon the difference between the basis to him of the 60 shares and their fair market value at the time of the exchange.

Example (2). Individuals C and D each transferred, to a newly organized corporation, property having a fair market value of $4,500 in exchange for the issuance by the corporation of 45 shares of its capital stock to each transferor. At the same time, the corporation issued to E, an individual, 10 shares of its capital stock in payment for organizational and promotional services rendered by E for the benefit of the corporation. E transferred no property to the corporation. C and D were under no obligation to pay for E's services. No gain or loss is recognized to C or D. E received compensation taxable as ordinary income to the extent of the fair market value of the 10 shares of stock received by him.

Sec. 1.351-2. Receipt of property.

(a) If an exchange would be within the provisions of section 351(a) if it were not for the fact that the property received in exchange consists not only of property permitted by such subsection to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property. No loss to the recipient shall be recognized.

(b) See section 357 and the regulations pertaining to that section for applicable rules as to the treatment of liabilities as "other property" in cases subject to section 351, where another party to the exchange assumes a liability, or acquires property subject to a liability.

(c) See sections 358 and 362 and the regulations pertaining to those sections for applicable rules with respect to the determination of the basis of stock, securities, or other property received in exchanges subject to section 351.

(d) See Part I (section 301 and following), subchapter C, chapter 1 of the Code, and the regulations thereunder for applicable rules with respect to the taxation of dividends where a distribution by a corporation of its stock or securities in connection with an exchange subject to section 351(a) has the effect of the distribution of a taxable dividend.

* * * * *

Sec. 1.355-1. Distribution of stock and securities of controlled corporation.

(a) *Application of section.* Section 355 provides for the separation, without recognition of gain or loss to the shareholders and security holders, of two or more existing businesses formerly operated, directly or indirectly, by a single corporation. It applies only to the separation of existing businesses which have been in active operation for at least five years, and which, in general, have been owned for at least five years by the corporation making the distribution of stock or of stock and securities. Section 355 does not apply to the division of a single business.

For the purpose of section 355, stock rights or stock warrants are not included in the term 'stock and securities'.

(b) *Types of separations.* Section 355 is concerned with two general types of separations of businesses. The first is the distribution of the stock of an existing corporation. The second is the distribution of the stock of a new corporation which stock was received in exchange for the assets of a business previously operated by the distributing corporation. In both cases, this section contemplates the continued operation of the businesses existing prior to the separation.

* * * * *

Sec. 1.355-2. Limitations.

(a) *Property distributed.* The property distributed must consist solely of stock or stock and securities of a controlled corporation. If additional property (including an excess principal amount of securities received over securities surrendered) is received, see section 356.

(b) *Distribution of earnings and profits.* (1) The transaction must not have been used principally as a device for the distribution of the earnings and profits of the distributing corporation or of the controlled corporation or of both. If, pursuant to an arrangement negotiated or agreed upon prior to the distribution of stock or securities of the controlled corporation, part or all of the stock or securities of either corporation are sold or exchanged after the distribution, such sale or exchange will be evidence that the transaction was used principally as a device for the distribution of the earnings and profits of the distributing corporation or of the controlled corpo-

ration, or both. However, if the rules respecting continuity of interest contained in paragraph (c) of this section are not met, section 355 will not apply. If a sale of such stock or securities is made after the distribution and is not pursuant to an arrangement negotiated or agreed upon prior to the distribution, the mere fact of such sale is not determinative that the transaction was used principally as a device for the distribution of earnings and profits, but such fact will be evidence that the transaction was used principally as such a device.

(2) A sale is pursuant to an arrangement agreed upon prior to the distribution when enforcible rights to buy or to sell exist before such distribution. In any case in which a sale or exchange was discussed by the buyer and the seller before the distribution, but enforcible rights to buy or to sell did not exist before such distribution, the question whether an arrangement was negotiated within the meaning of section 355(a)(1)(B) shall be determined from all the facts and circumstances.

(3) In determining whether a transaction was used principally as a device for the distribution of the earnings and profits of the distributing corporation or of the controlled corporation or both, consideration will be given to all of the facts and circumstances of the transaction. In particular, consideration will be given to the nature, kind and amount of the assets of both corporations (and corporations controlled by them) immediately after the transaction. The fact that at the time of the transaction substantially all of the assets of each of the corporations involved are and have been used in the active conduct of trades or businesses which meet the requirements of sec-

tion 355(b) will be considered evidence that the transaction was not used principally as such a device.

(c) *Business purpose.* The distribution by a corporation of stock or securities of a controlled corporation to its shareholders with respect to its own stock or to its security holders in exchange for its own securities will not qualify under section 355 where carried out for purposes not germane to the business of the corporations. The principal reason for this requirement is to limit the application of section 355 to certain specified distributions or exchanges with respect to the stock or securities of controlled corporations incident to such readjustment of corporate structures as is required by business exigencies and which, in general, effect only a readjustment of continuing interests in property under modified corporate forms. Section 355 contemplates a continuity of the entire business enterprise under modified corporate forms and a continuity of interest in all or part of such business enterprise on the part of those persons who, directly or indirectly, were the owners of the enterprise prior to the distribution or exchange. All the requisites of business and corporate purposes described under § 1.368 must be met to exempt a transaction from the recognition of gain or loss under this section.

(d) *Stock and securities distributed.* The distributing corporation must distribute—

(1) All of the stock and securities of the controlled corporation which it owns, or

(2) At least an amount of the stock which constitutes control as defined in section 368(c). In such

case all, or any part, of the securities of the controlled corporation may be distributed.

Where a part of either the stock or securities is retained under (2), it must be established to the satisfaction of the Commissioner that such retention was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax. Ordinarily, the business reasons (as distinguished from the desire to make a distribution of the earnings and profits) which support a distribution of stock and securities of a controlled corporation under paragraph (c) of this section will require the distribution of all of the stock and securities. If the distribution of all of the stock and securities of a controlled corporation would be treated to any extent as a distribution of 'other property' under section 356, this fact does not tend to establish that the retention of any of such stock and securities is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax.

(e) *Principal amount of securities.* (1) Section 355(a)(1) is not applicable if the principal amount of securities received exceeds the principal amount of securities surrendered or if securities are received and no securities are surrendered. In such cases, see section 356.

(2) If only stock is received in a transaction to which section 355 is applicable, the principal amount of securities surrendered, if any, and the par or stated value of stock is not relevant to the application of such section. For example: All of the stock of Corporation A is owned by X, an individual, and securities in the principal amount

of $100,000 which were issued by Corporation A are owned by Y, an individual. Corporation A distributes all of the stock of a controlled corporation to Y in exchange for his securities. The par or stated value of the stock of the controlled corporation is $150,000. No gain or loss is recognized to Y upon the receipt of the stock of the controlled corporation.

(f) *Period of ownership.* (1) For the purposes of determining whether gain or loss will be recognized upon a distribution, stock of a controlled corporation acquired (in a transaction in which gain or loss is recognized, in whole or in part) within five years of the date of the distribution of such stock is treated as 'other property'. Section 355 does not apply to a transaction which includes a distribution of such stock. See section 356. The stock so acquired is 'stock', however, for the purpose of the requirements respecting the distribution of stock of such controlled corporation provided in section 355(a)(1)(D).

(2) Paragraph (f)(1) of this section may be illustrated by the following example:

Example. Corporation A has held 85 of the 100 outstanding shares of the stock of Corporation B for more than five years on the date of distribution. Six months before such date, it purchased 10 shares of such stock. If all of the stock of the controlled corporation owned by Corporation A is distributed, section 355 is not applicable to such distribution since the 10 shares would represent 'other property.' See, however, section 356. If, however, for proper business reasons it is decided to retain some of the stock of Corporation B, then the determination of

the amount of such stock which must be distributed under section 355(a)(1)(D) in order to constitute a distribution to which section 355 is applicable must be made by reference to all of the stock of the controlled corporation including the 10 shares acquired six months before such date and the 5 shares owned by others. Similarly, if, by the use of any agency, the distributing corporation acquires stock of the controlled corporation within five years of the date of distribution, for example, where another subsidiary purchases such stock, such stock will be treated as 'other property.' If Corporation A had held only 75 of the 100 outstanding shares of stock of Corporation B for more than five years on the date of distribution and had purchased the remaining 25 shares six months before such date, neither section 355 nor section 356 would be applicable.

(G) *Active businesses.* The rules of section 355(b) and § 1.355-4, relating to active businesses, must be satisfied.

* * * * *

Sec. 1.1502-31. Bases of tax computation.

* * * * *

(b) *Computations.* In the case of affiliated corporations which make, or are required to make, a consolidated return, and except as otherwise provided in the regulations under section 1502:

(1) *Taxable income.* The taxable income of each corporation shall be computed in accordance with the provisions covering the determination of taxable income of separate corporations, except:

(i) There shall be eliminated unrealized profits and losses in transactions between members of the affiliated group and dividend distributions from one member of the group to another member of the group (referred to in the regulations under section 1502 as intercompany transactions);

* * * * *

No. 20863

IN THE UNITED STATES COURT OF APPEALS

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COMMISSIONER OF INTERNAL REVENUE,

Petitioner

v.

OSCAR E. BAAN and EVELYN K. BAAN,

Respondents

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

REPLY BRIEF FOR THE PETITIONER

RICHARD M. ROBERTS,
Acting Assistant Attorney General.

LEE A. JACKSON,
GILBERT E. ANDREWS,
MARTIN T. GOLDBLUM,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

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The Commissioner, in his "Specification Of Errors Relied Upon," asserted that the Tax Court erred in failing to hold that taxpayers "realized dividend income to the extent of the difference between the price which they paid for the Northwest stock, and the fair market value of such stock." (Br. 7.) In the subsequent development of the argument, the Commissioner contended both that taxpayers "realized a profit on the distribution of the rights which is taxable as a dividend" (Br. 8) and that "the profit resulting from the exercise of the rights" is taxable as a dividend (Br. 16). The interchangeable use of the terms "distributi and "exercise" afforded taxpayers with an opportunity (fully exploited in

their brief) to argue that the Commissioner's position on this appeal is contrary to Palmer v. Commissioner, 302 U.S. 63, where the Supreme Court concluded that (p. 71), "The mere issue of rights to subscribe and their receipt by stockholders is not a dividend." (Emphasis supplied.)

As the Tax Court correctly observed in its opinion (I-R. 110):

> There is no serious question that, apart from certain specific provisions of the 1954 Code, the exercise of rights by Pacific's stockholders in the circumstances of this case would result in their receiving taxable dividends equal to the excess of the value of the Northwest stock over the subscription price. So much is clear from such decisions as Palmer v. Commissioner, 302 U.S. 63, and Choate v. Commissioner, 129 F. 2d 684 (C.A. 2d). [Footnote omitted.]

In short, the case law (including Palmer) renders the distribution taxable, and the single question on this appeal is whether the simulated "spin-off" here qualifies under the nonrecognition provisions of Section 355 and renders the distribution nontaxable. Accordingly, the dispute over whether taxpayers received a dividend when the rights were issued or when they were exercised is mere scholasticism except as it bears upon the proper interpretation of the terms of Section 355.

At pages 19-22 of the Commissioner's opening brief, it was pointed out that Section 355(a)(1)(A) required Pacific to distribute "to a shareholder, with respect to its stock * * * solely stock or securities of a corporation which it controls * * *." It was stressed that all that Pacific distributed here "with respect to its stock" were transferable rights to purchase Northwest stock (for six rights and $16 per share) and that such rights are not "stock or securities" under Helvering v. Southwest Corp., 315 U.S. 194, and Section 1.355-1(a) of the Treasury Regulations on Income Tax (1954 Code). The Northwest stock itself was

not distributed to taxpayers "with respect to" their status as shareholders of Pacific but to anyone who came forward with six rights and \$16. Seemingly barred from nonrecognition by the plain terms of Section 355(a)(1)(A), it has been taxpayers' strategy to contend that the rights themselves should be disregarded entirely, that Pacific obviously did "distribute" something to its shareholders "with respect to" their stock and that the only something in sight is the stock of Northwest. In this manner, taxpayers hope to slide the transaction within the terms of Section 355(a)(1)(A), i.e., by hammering away (with their interpretation of Palmer) at the proposition that the distribution of rights was a nullity within the contemplation of the statute, until coupled with the physical distribution of Northwest stock, and that the latter step is the only one to be considered under the statute.

Of course, a difficulty immediately confronting taxpayers in maintaining their position that the rights themselves should be ignored is the holding of the Tax Court that the Pacific shareholders who did not receive Northwest stock but elected to sell their rights received a dividend distribution. (I-R. 125-127.) Pointing out the further difficulties inherent in that position is the sole purpose of this short reply brief.

As a matter of logic and because the Supreme Court so stated in Palmer (p. 71), "The mere issue of rights to subscribe and their receipt by shareholders is not a dividend." (Emphasis supplied.) What happened in Palmer (unlike the facts in the case at bar) is that a corporation issued rights to its shareholders to acquire the stock of another corporation at a price which reflected the fair market value at the

date of issuance.[1/] Prior to the exercise of the rights, however, the value of the offered stock went up, and the question as stated by the Court was (pp. 70-71):

> * * * whether the commitment of Superpower * * * to the sale of United stock at its then fair market value and the ensuing distribution to stockholders is taken out of the category of sales and placed in that of dividends by the fact that, pending execution of the project, rights to subscribe sold on the exchange at substantial prices, or that the stock itself sold at prices substantially above the stipulated purchase price.

Answering that question in the negative, the Supreme Court stated that (p. 73):

> It is decisive of the present case, so far as the first allotment of United shares is concerned, that distribution of corporate assets, effected by the sale, was not intended to be a means of distributing earnings, and that the price when fixed represented the fair market value of the property to be distributed.

To be sure, the Supreme Court, by way of dictum, earlier (p. 71) had observed that the rights themselves were in the nature of options and that until they were exercised, no distribution of corporate assets or diminution of the corporation's net worth resulted in any practical sense. Significantly, however, in a later case (Commissioner v. LoBue,

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1/ Where a corporation intentionally sets a price on property (to be sold to its shareholders) which is below fair market value, as in the case at bar, the Supreme Court had this to say (Palmer, p. 69):

> On the other hand such a sale, if for substantially less than the value of the property sold, may be as effective a means of distributing profits among stockholders as the formal declaration of a dividend. The necessary consequence of the corporate action may be in substance the kind of a distribution to stockholders which it is the purpose of §115 to tax as present income to stockholders, and such a transaction may appropriately be deemed in effect the declaration of a dividend, taxable to the extent that the value of the distributed property exceeds the stipulated price. * * *

351 U.S. 243) the Supreme Court decided that an employee who received an option to acquire stock of his corporate employer (at a price below fair market value) should be taxed at the time the option was exercised (rather than at the time of issuance) solely because the option was not transferable. The majority opinion states (p. 249):

> It is of course possible for the recipient of a stock option to realize an immediate taxable gain. See Commissioner v. Smith, 324 U.S. 177, 181-182. The option might have a readily ascertainable market value and the recipient might be free to sell his option. But this is not such a case.

Two dissenting justices took the position that an immediate taxable gain took place upon the issuance of the options although they could not be sold and might never be exercised (pp. 250-252).

Accordingly, it is far from clear that the dictum in Palmer (that there could be no distribution of corporate assets in a practical sense until the rights were exercised) survives what was later stated in LoBue. It should also be noted that in a subsequent application of Palmer, it was held that when rights are issued by a corporation to acquire stock at a bargain price and those rights subsequently are exercised, ~~issued,~~ the dividend taxable to the shareholder is measured by the difference between (1) fair market value at the date of issuance and the option price or (2) by the difference between fair market value at the date of exercise and the optio price, whichever is the lesser. Choate v. Commissioner, 129 F. 2d 684, 68 (C.A. 2d). The "distribution" to a shareholder under these circumstances is measured by (in that it cannot exceed) the spread between fair market value of the property at the date the rights are issued and the option price.

Viewed in light of the foregoing, it is believed that when Pacific issued transferable rights to taxpayers to acquire Northwest stock at a bargain price, these valuable rights became a charge on the assets of Pacific and there was a "distribution" to them at that time of earnings and profits of Pacific which was extinguishable only if they subsequently failed to exercise or sell the rights (both unrealistic alternatives) and reducible only by an intervening drop in fair market value.

Emphatically, however, it is not necessary for this Court to decide whether the issuance and receipt by taxpayers of rights to acquire Northwest stock was a taxable event under the circumstances of this case. It is sufficient for the purposes of this litigation, that, under no reasonable construction of the facts or of Section 355(a)(1)(A), can it be considered that all that happened here was a "distribution" of Northwest stock to taxpayers "with respect to" their stock in Pacific. 2/

Respectfully submitted,

RICHARD M. ROBERTS,
Acting Assistant Attorney General.

LEE A. JACKSON,
GILBERT E. ANDREWS,
MARTIN T. GOLDBLUM,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

DECEMBER, 1966.

2/The Tax Court was criticized in the Commissioner's opening brief (p. 20) f the conclusion that the stock of Northwest was "literally 'distributed' to petitioners [taxpayers], albeit for a consideration * * *." (I-R. 117.) Taxpayers, however, find this statement "squarely in accord" (Br. 23) with the statement in Palmer (p. 69) that "a sale of corporate assets to a stockholder is, in a literal sense, a distribution of its property." What taxpay overlook is that the Tax Court's observation was in the context of a "distribution" of Northwest stock to the shareholders of Pacific entirely "with res to" their stock in Pacific. (I-R. 117.) The dictum in Palmer is not addres to that question. Accordingly, the view that a distribution may be both "fo consideration" and a distribution "with respect to" stock is original with t Tax Court.

CERTIFICATE

I certify that, in connection with the preparation of this reply brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing reply brief is in full compliance with those rules.

Dated: ______________________ day of __________________, 1966.

____
Attorney

TABLE OF CONTENTS

	Page
Jurisdictional Statement	1
Statement of the Case	2
A. The Issues	2
B. The Controlling Facts Are Not In Dispute	4
C. The Nature and Advantages of the Patented Invention	6
D. The Commercial Bulkheads of the Parties	9
E. Background of Patented Invention—The Invention Filled a Long-Felt Need for Permanent Freight Bracing Equipment	10
F. The Accused Structures	14
1. Models BD-6 and BD-2—Full Width Bulkheads	15
2. Accused Model BC-3	18
3. Accused Model BC-4	19
4. Accused Model BE-2	19
Specification of Errors	20
Summary of Argument	22
Argument	28
I. Infringement	28
A. In General	28
B. Preco Models BD-6 and BD-2	28
1. The Claims Read in Terms Upon Preco Models BD-6 and BD-2	28
2. The District Court was Misled by Preco's Gross Misapplication of the Claim Language	29

Page

3. Claim 1 29
4. Claim 2 37
5. Claim 3 39
6. The Errors of the District Court As To Infringement Are Errors of Law 41
7. There Is No File Wrapper Estoppel.. 46

C. Accused Model BC-3.................. 47
D. Accused Model BC-4.................. 49
E. Model BE-2 50

II. Validity 51

A. The Indicia of Invention.............. 51
B. The Construction of the Wells Patent in Suit Has Novelty and Utility........... 57
C. The Holding of the District Court That the Invention of the Wells Patent in Suit Was Obvious Was an Erroneous Conclusion of Law 58
D. The Prior Art Does Not Suggest the Wells Combination 60
E. The Combination of the Patent in Suit Meets the Test of the A & P Case...... 65

Conclusion 68

Appendix A:

DX AB—Chart re accused Model BC-3........ 1a
DX AC—Chart re accused Model BC-4........ 2a
DX AE-1—Chart re accused Model BD-2...... 3a
DX AF—Chart re accused Model BD-2........ 4a
DX AG, page 4—Page from brochure showing Evans' DF-B bulkhead equipment........ 5a

Page

DX AX-2—Photograph showing accused Model BD-6 .... 6a

DX AO-2—Photograph showing Evans' DF-B bulkhead equipment 7a

DX AZ-1—Claim chart re Claim 1 of Wells patent in suit 8a

DX AZ-2—Claim chart re Claim 2 of Wells patent in suit 9a

DX AZ-3—Claim chart re Claim 3 of Wells patent in suit 10a

Appendix B:

Plaintiff's Exhibits 11a

Defendant's Exhibits 19a

TABLE OF AUTHORITIES CITED

Cases

Binks Mfg. Co. v. Ransburg Electro-Coating Corp., C.A. 7, 1960, 281 F. 2d 252.......... 54

Catalin Corp. of America v. Catalazuli Mfg. Co., C.A. 2, 1935, 79 F. 2d 593.......... 45

The Cold Metal Process Co. v. Republic Steel Corp., C.A. 6, 1956, 233 F. 2d 828.......... 65

Coleman Co. v. Holly Mfg. Co., C.A. 9, 1956, 233 F. 2d 71 .... 27, 63

Continental Connector Corp. v. Houston Fearless Corp., C.A. 9, 1965, 350 F. 2d 183.......... 5

Elrick Rim Co. v. Reading Tire Machinery Co., C.A. 9, 1959, 264 F. 2d 481.......... 26, 59

Goodyear Tire & Rubber Co. v. Ray-O-Vac Co., 321 U.S. 275, 88 L. Ed. 721.......... 27, 62

Page

Graham et al v. John Deere Co., 1966, 383 U. S. 1, 15 L. Ed. 2d 545....................3, 5, 23, 26, 54, 58

Graver Tank & Mfg. Co. v. Linde Air Products Co., 339 U.S. 605, 94 L. Ed. 1097...............24, 42, 43

Great Atlantic & Pacific Tea Co. v. Supermarket Equipment Corp., 1951, 340 U.S. 147, 95 L. Ed. 162 .... 5, 66

Hansen v. Colliver, C.A. 9, 1960, 282 F. 2d 66..5, 24, 35, 41

Hayes Spray Gun Co. v. E. C. Brown Company, C.A. 9, 1961, 291 F. 2d 319............23, 25, 37, 43, 57

Intricate Metal Products Inc. v. Schneider, C.A. 9, 1963, 324 F. 2d 555.......................... 40

Kaakinen v. Peelers Co., C.A. 9, 1962, 301 F. 2d 170 ....23, 56, 65

National Sponge Cushion Co. v. Rubber Corp. of Cal. C.A. 9, 1961, 286 F. 2d 731..............27, 57, 62

Neff Instrument Corporation v. Cohu Electronics Inc. C,A. 9, 1961, 298 F. 2d 82..........23, 24, 25, 27, 41, 43, 57, 63

No-Joint Concrete Pipe Co. v. Hanson, C.A. 9, 1965, 344 F. 2d 13..............................27, 40, 6

Oxnard Canners v. Bradley, C.A. 9, 1952, 194 F. 2d 655 .... 25, 4

Payne Furnace & Supply Co. v. Williams-Wallace Co., C.A. 9, 1941, 117 F. 2d 823............... 27, 6

Pointer v. Six Wheel Corp., C.A. 9, 1949, 177 F. 2d 153 ....23, 27, 56, 6

Pursche v. Atlas Scraper & Engineering Co., C.A. 9, 1962, 300 F. 2d 467..........23, 24, 27, 33, 45, 57, 6

Reiner v. I. Leon Co., C.A. 2, 1960, 285 F. 2d 501.... 5

Ry-Lock Co. Ltd. v. Sears, Roebuck & Co., C.A. 9, 1955, 227 F. 2d 615......................... 27, 6

Smith v. Snow, 294 U.S. 1, 79 L. Ed. 721............ 3

Page

Stearns v. Tinker & Rasor, C.A. 9, 1955, 220 F. 2d 49 23, 57, 61

Temco Electric Motor Co. v. Apco Mfg. Co., 275 U.S. 319, 72 L. Ed. 298 .... 25, 42

Troy Co. v. Products Research Co., C.A. 9, 1964, 339 F. 2d 364 ....27, 63, 65

Twentier's Research Inc. v. Hollister Incorporated, 1963, 319 F. 2d 898..........................23, 57, 66

Statutes

United States Code, Title 28, Sec. 1338............ 2

United States Code, Title 28, Sec. 2201............ 2

United States Code, Title 28, Sec. 1291............ 2

United States Code, Title 35, Sec. 112............. 3

United States Code, Title 35, Sec. 103........26, 54, 58, 68

United States Code, Title 35, Sec. 282............. 26, 59

Rules

Federal Rules of Civil Procedure, 73(a).......... 2

United States Court of Appeals for the Ninth Circuit

No. 20,868

EVANS PRODUCTS COMPANY,
Defendant-Appellant,
vs.
PRECO INCORPORATED,
Plaintiff-Appellee.

APPELLANT'S BRIEF

JURISDICTIONAL STATEMENT

This is an appeal from a final judgment entered by the District Court of the United States for the Southern District of California, Central Division, relating to United States Patent No. 2,543,143 issued February 27, 1951 and owned by Defendant-Appellant, Evans Products Company (herein referred to as Evans).

This action was brought for declaratory judgment in a controversy arising under the patent laws of the United

States and Evans counterclaimed for patent infringement. Jurisdiction of the District Court is founded on Sections 1338 and 2201 of Title 28 of the United States Code. The pleadings showing the existence of jurisdiction are the Complaint for Declaratory Judgment Relief in connection with United States Patent No. 2,543,143, Defendant Answer to Complaint and Defendant's Counterclaim, and Plaintiff's Reply to Counterclaimant's Counterclaim (R. 2-17).* The final judgment (R. 404) was entered January 11, 1966 and Defendant's notice of appeal (R. 406) was filed February 9, 1966 within the period authorized by Rule 73(a) of the Federal Rules of Civil Procedure. This Court's jurisdiction of this appeal is provided for in Section 1291 of Title 28 of the United States Code.

STATEMENT OF THE CASE

A. The Issues

Two basic issues are presented by this appeal. First, whether the District Court erred in holding the Wells et al United States Patent No. 2,543,143 to be invalid and second, whether it erred in holding that the Wells patent** has not been infringed by the Appellee, Preco Incorporated.

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* The Transcript of Record filed with the clerk on this appeal is in three volumes. The Clerk's Record in two volumes is reproduced in one volume and bears page markings 1 through 415. References to this Clerk's Record appear in this brief as R. followed by the appropriate page number as (R. 1). Volume III is the reporter's transcript in 14 volumes and references to this reporter's transcript appear herein as TR. followed by the appropriate page number as (TR. 1).

** The patent in suit in this case is Wells et al. No. 2,543,143 and will be referred to herein either as the Wells patent or simply the patent in suit. There is another Wells Patent No. 1,646,604 in the prior art.

The patent in suit covers a novel bulkhead or load divider installation for a transport vehicle such as a truck or railway boxcar.

The pivotal issue in this case is the issue of infringement. This follows from the fact that the accused bulkhead constructions sold by Preco are substantially identical to the bulkheads sold by Evans which have enjoyed a substantial commercial success. If, as asserted by Evans, the constructions of both parties embody the invention of the patent in suit, then not only is the issue of infringement resolved but in addition, the undisputed fact that the commercial constructions of both parties filled a long-felt need is one of those factors which weighs heavily in favor of a conclusion that the concept of the invention was unobvious. *Graham et al v. John Deere Co.,* 383 U.S. 1; 15 L. Ed. 2d 545, 556.

An entirely fallacious non-infringement argument advanced by Preco led the District Court not only into the error of holding that the accused bulkheads do not infringe, but by the same token led the Court to disregard the undisputed evidence that the commercial constructions of both parties had filled a long-felt need, and to make the further irrelevant holding that the construction shown in the Wells patent had not been commercialized. (Finding No. 27, R. 394.)

While there is no evidence of commercial use of the embodiment of the invention illustrated in the Wells patent, which is a cattle truck installation, the District Court evidently failed to appreciate the distinction between an invention, which can be embodied in many forms, and the particular embodiment selected by the inventor to illustrate his invention. Section 112 of the statute (35 U.S.C.) recognizes this distinction by requiring that the application describe

> "the best mode contemplated by the inventor of carrying out his invention".

Implicit in this language is the recognition that an invention can be carried out in other modes.

An invention can achieve commercial success and fill a long-felt need in embodiments other than that illustrated. While Wells et al evidently believed that the cattle truck embodiment was the best mode of carrying out the invention, they did state that it could be used in boxcars and the great commercial success of the invention proved to be in that field.

The issue of infringement is thus at the very heart of the present appeal and once it is appreciated that the accused devices are infringements of the patent in suit, it will be obvious that Evans' product also embodies the invention of the patent in suit and that the patent has, in fact, filled a long-felt need and had a remarkable commercial success. These facts, when added to the conceded novelty of the Wells' invention and the unchallengeable advantages which flow from its use, provide overwhelming support for the presumption of validity.

B. The Controlling Facts Are Not In Dispute

On the issue of infringement, there is no issue of fact. There is no disagreement as to what Preco's accused structures are or how they operate; and the specifications and claims of the patent contain no technical terms requiring expert elucidation. There is disagreement as to whether these accused constructions and the similar constructions sold by Evans come within the scope of the claims of the patent in suit when they are properly construed and applied. But this is a matter of law for determination by the

Court on the undisputed facts. (*Hansen v. Collirer*, 282 F. 2d 66, 69 (C.A. 9) 1960). Also, the file wrapper estoppel argument presents a question of law for the Court rather than any disputed issue of fact.

On the issue of validity the evidence adduced does not present any disputed fact question. The prior art upon which Preco relies consists entirely of United States patents, all of which are in the Book of Prior Art Patents Relied Upon by the Plaintiff (PX 2) and are individually identified by the marks 2-A through 2-S. There is no dispute as to the construction or operation of the equipment disclosed in these patents. Both parties offered evidence showing the background of the patented invention and the long-felt need for such permanent freight bracing equipment; and there is no dispute as to the commercial success of the constructions claimed by Evans to be within the scope of the claims of the patent in suit.

That leaves only legal grounds of attack on the validity of the patent. Thus, the question of whether the structure of the Wells et al patent in suit is an aggregation, as distinguished from patentable combination of old elements is a question of law for the Court (*Great Atlantic & Pacific Tea Co. v. Supermarket Equipment Corp.*, 340 U.S. 147, 95 L. Ed. 162 (1951) and *Continental Connector Corp. v. Houston Fearless Corp.*, 350 F. 2d 183, 191, (C.A. 9) 1965), as is the "ultimate" question of whether, in the light of the established facts, what Wells et al did meets the standard of patentable invention required by law (*Graham et al v. John Deere Co.*, 383 U.S. 1, 15 L. Ed. 2d 545, 556).

C. The Nature and Advantages of the Patented Invention.

The subject matter of the Wells patent (DX A)* is a permanently but adjustably mounted partition on bulkhead for dividing the cargo space in a transport vehicle and for retaining the goods to be transported in position in the cargo space. The embodiment of the invention illustrated and described in the patent is mounted in a highway truck of the type which is utilized in transporting livestock, although the patentees recognized that the invention was of broader application, as is clear from the opening statement of the patent specification which reads as follows:

> "The present invention relates to the transportation art and more particularly to trucks, railroad cars and the like, which are adapted for transporting merchandise therein and particularly livestock."

The devices sold by both parties are used in otherwise conventional railroad boxcars to retain miscellaneous freight in position in the car. They are generally referred to as bulkheads, partitions, or load dividers. Their function is to retain freight in position against its tendency to move out of position when the freight car is bumped or otherwise jostled during transit and by retaining the freight in position, the bulkheads facilitate unloading and prevent damage to the freight. For this purpose a very heavy and sturdy construction is required and a major problem in the art is to provide a permanent mounting for such a heavy unit, which would permit easy movement and adjustment to a wide variety of positions.

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* Evans' exhibits are referred to herein by the letters DX followed by the letter designation of the exhibit as (DX A) and Preco's exhibits are referred to herein by the letters PX followed by the number designation of the exhibit as (PX 1).

Referring to the patent in suit (DX A), its essential elements and their mode of operation may be briefly described as follows. As best shown in Figures 1 and 3, the vehicle body has side walls which are indicated generally by the numerals 18 and 20. The bulkhead or partition 40 extends substantially the full width of the interior of the body when positioned transversely of the body, as illustrated in Figure 3 and is suspended by a connection 56 at the midpoint of its upper edge. The connection 56 not only suspends the bulkhead, but permits a pivotal movement of the suspended bulkhead about a vertical axis between a position in which it extends transversely of the vehicle body and a position in which it extends parallel to the side walls. The pivotal suspension 56 is carried by a trolley mechanism or bracket 54 which runs on a transverse bar 42 so that when the bulkhead is swung into a plane parallel to the side walls of the vehicle, it may be moved flat against a side wall, as shown in Figure 4. It will be noted that Figure 4 shows the bulkhead at the left-hand side of the vehicle body where it is out of the way during loading or unloading. It may, in the same manner, be moved over against the right-hand side, if desired.

The transverse bar 42 may be moved along the length of the vehicle body in either direction, thus permitting the bulkhead, when in its transverse load retaining position shown in Figure 3, to be positioned at any point along the length of the body. Also, it will be appreciated that the bulkhead may be positioned at any point along either side wall of the body; one of which positions is shown in Figure 4.

The bulkhead may be secured in any desired position transversely of the vehicle body by latching it directly to the side walls. This is achieved by latch pins 80 which pro-

ject horizontally from the side edges of the bulkhead and which engage in appropriate openings 104 formed in the longitudinal bars 100 and 102 which are secured to the side walls. These latch pins 80 are normally urged into an outward or locking position by springs 94. Handles 92 and an associated linkage mechanism are provided for retracting the latch pins.

The invention of the Wells et al patent in suit resides in a combination of elements which co-act in a novel manner to produce a new and useful result not hitherto achieved by any prior bulkhead construction. The features of the invention which distinguish it from the prior art and are responsible for its superior performance are the combination of a bulkhead suspended from a transverse bar in a car body by a connection which is movable along the length of the bar and which provides for pivotal movement of the bulkhead about a vertical axis, with rails on which the ends of the bar are supported to permit movement of the transverse bar on the rails along the length of the car body, and with means for latching the bulkhead to the car body in a plurality of positions along the length of the car body (TR. 570-71).

This structure has a number of important functions and advantages. First, it permits the suspension of the bulkhead from a point over its center gravity for movement while extending transversely of the car to any desired position of use along the length of the car, and also for movement out of the way parallel to and adjacent either wall of the car body at any point along the length of the car (TR. 571). This provides a universal adjustment of the bulkhead which is not found in any prior construction. Moreover, these movements are easily effected by a single workman nothwithstanding the fact that Evans' embodi-

ments of the invention of the patent in suit weigh from seven or eight hundred pounds up to seventeen or eighteen hundred pounds (TR. 879).

The novel combination of the patent in suit provides a permanently mounted bulkhead assembly of maximum flexibility and ease of operation with minimum structural weight.

The patent in suit has only three claims, all of which are involved in the present appeal. Claim 1 is most broadly directed to the combination above described. Claim 2 more specifically recites that the transverse bar is channel-shaped in cross section, with a partition supporting bracket movable in the channel. Claim 3 adds a recitation of latches resiliently urged toward latching position together with detailed operating means therefore.

D. The Commercial Bulkheads of the Parties

A general understanding of the equipment manufactured and sold by the parties to this suit can be obtained from a consideration of DX AG which is a brochure of Evans showing the construction, installation and operation of its DF-B equipment (TR. 156-57) and a consideration of the photographs DX AN 1-6 and the charts DX AE-1 and 2 and AF* showing one of the several accused bulkheads designs manufactured and sold by Preco and charged to

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* These charts are part of a group of charts DX Y to AF which are stipulated to correctly illustrate the accused constructions (except for a stipulated correction to the shape of the rails in Model BD-2 shown in DX AE-1 and 2 and AF), although Preco reserved the right to challenge the numerals and words appearing on the charts (DX AR).

For convenience of reference, conformed copies of DX AG, page 4, DX AN-2, DX AE-1 and DX AF are reproduced in the Appendix hereto.

infringe the Wells patent. It will be noted that in each the bulkheads are large structures which extend substantially the full width of the boxcar and from the floor to a point adjacent the top of the side wall. Also, it will be noted that each bulkhead is supported at the center of its upper edge through a pivotal connection, by a carriage or trolley mounted on a transverse beam by roller means permitting the carriage or trolley to be moved along the transverse beam. The transverse beam in each of these constructions extends completely across the boxcar and is supported at its opposite ends on rails extending longitudinally of the boxcar by rollers which permit the transverse beam to be moved longitudinally of the boxcar. Each bulkhead also includes lockpins at four spaced locations and engageable with latching strips fixed to the boxcar structure for holding the bulkhead in any of a plurality of freight bracing positions which are spaced longitudinally of the boxcar and in each of which the bulkhead extends transversely of the boxcar. These structures have all the essential features of the Wells patent.

E. Background of Patented Invention—The Invention Filled a Long-Felt Need for Permanent Freight Bracing Equipment*

The railroads have long been plagued with excessive damage claims based on the damage of freight resulting from the rough handling to which freight cars are subject (TR. 469-471). One of the principal causes of damage is the severe bumping to which railroad freight cars are subjected

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* The facts set forth in this section are undisputed except that Preco denies that the constructions sold by both parties and which have filled the long-felt need embody the invention of the Wells patent. This fallacious argument is disposed of later in this brief.

during the make-up and break-down of trains in freight yards. It is the universal practice to bump cars together to effect a coupling, and in order to speed the make-up of trains, this is done at relatively high speed. Thus, a car may be run into a standing string of freight cars at speeds as high as 10, 12 or 15 miles per hour (TR. 468). The shock and stress placed on the freight under these circumstances is exceedingly high (TR. 466, 878). In addition to these stresses, very similar shocks occur during sudden braking and starting operations when the slack between cars runs out or runs in and the accumulated slack provides a crack-the-whip effect (TR. 468). Also, freight trains in travelling at high speeds are subjected to severe vertical vibrations (TR. 535) and side-sway, which also tend to work freight loose from any means which may be provided to hold it in position. The combined effect of all of these factors makes it absolutely essential to provide means effective to hold the freight in position in the car during transport (TR. 466, 469).

In years past the usual practice was to provide heavy timbers which were nailed in place to the floor and walls of the boxcar and which engaged the freight. This practice was so widespread that even today all freight cars are provided with wooden floors and side walls to which freight bracing timbers may be nailed. Needless to say, the cost of such timbers, the labor involved in installing and removing them, and the fact that they are almost always thrown away at the end of a single trip, has very materially added to the expense of rail shipments (TR. 476). This cost and the continuing high incidence of freight damage has been responsible for the loss of a great deal of rail freight business to the highway truckers (TR. 524, 558).

The railroads and their equipment suppliers have been desperately searching for some better and more economical

way of bracing freight (TR. 474-484). Amig, who had life-long experience with The Pennsylvania Railroad, explained that freight damage, with which he had been concerned throughout most of his employment, was one of the most serious problems which the railroads have (TR. 471) averaging around eight million dollars each year to the Pennsylvania Railroad alone. Beginning in the 1930's the Pennsylvania first developed loose bulkheads (TR. 474), then later the PD crossbar system with perforated steel linings on the side walls (TR. 477).

The Defendant, Evans Products Company, has been a leader in the development of permanent freight bracing equipment for use in railway freight cars. Its DF crossbar system (TR. 869) was quite an improvement over the PD crossbar (TR. 477-8) and variations of the DF crossbar system were made by Evans (TR 871). These freight bracing crossbars are effective for the purpose but have the disadvantage that they are not permanently connected to the car (TR. 478) and could become lost. They are shown in DX AW, page 429, in the upper photograph. These crossbars are heavy and difficult to handle and require considerable labor time in loading and unloading.

It has been recognized for many years that it would be desirable to have a permanently mounted partition or bulkhead which would hold the freight in position and could be moved easily to or from a desired freight bracing position in the car and also could be put into a position in which it would not interfere with the loading and unloading of freight. A number of patents have been granted on devices of this kind. DX AT is a collection of twenty-seven such patents dating from 1884. Also, Plaintiff's Book of Prior Art Relied on by Preco (PX 2) includes thirteen other patents relating to bulkheads for railroad freight cars. Evans had developed some fifteen different versions of

bulkheads in an attempt to solve the problem prior to its DF-B bulkhead which embodies the invention of the Wells patent in suit (TR. 912). Preco's counsel admitted in his opening statement (TR. 93) that the problem or need to which the patent in suit was directed had existed since 1941. The record here shows that railroads and numerous inventors have been working on this problem for many years before that. Preco has shown that it recognized the need and was working on the development of load dividers for refrigerator cars as early as 1940 and 1941 (PX 42 A-D, 43 A-C 44 A and B, TR. 425-7).

Since the Wells et al type bulkhead construction was placed on the market by Evans Products Company in 1959, it achieved immediate and substantial commercial success. Evans' bulkhead of this type has been marketed under the trademark DF-B and is shown in Evan's brochure DX AG and in the photographs DX AO 1, 2 and 3. The sales have literally skyrocketed from $4,610.00 in 1959 to a total of over $22,129,100 by June 30, 1965 and the sales in the first half of 1965 were over $5,000,000 (TR. 164-166). The Detailed DF-B Ownership List as of June 30, 1965 (DX AJ) shows that about forty-five different railroads and car leasing or operating companies owned over 13,000 car sets of this DF-B equipment as of June 30, 1965.

In addition to the large volume of sales by Evans of equipment embodying the invention of the Wells et al patent in suit, three of Evans' competitors have paid the patent in suit the compliment of marketing bulkheads embodying its essential features and the sales of these competitors further demonstrate the commercial success of the patent in suit in the solution of this problem of long standing in the railroad freight transport industry. One of these com-

petitors is Unarco Industries, Inc. of Chicago, Illinois, against which a final consent judgment of validity and infringement has been entered (DX AL) and which has taken a license (DX AK) providing for the payment of royalties of $25.00 per car set, and providing for other considerations for the right to use the invention of the Wells et al patent here in suit. The other considerations refer to the granting to Evans of a royalty-free license under another patent which expires in 1979, and upon which Unarco had brought suit against Evans, and the payment of $5,000 to Evans by Unarco. Another of these competitors is the present Plaintiff, Preco Incorporated, and the third is Transco, Inc. against which a suit for infringement of the Wells et al patent here in suit is pending in the District Court for the Southern Division of Illinois (TR. 828-30). This adoption by the freight bracing equipment industry of the essential features of the Wells et al patent in suit in place of other types of equipment previously made by them is strong evidence that the invention of the patent in suit was not obvious to those trying to fill the long-felt need for such freight bracing equipment.

F. The Accused Structures

There is no dispute as to the nature of the accused structures or their mode of operation. Preco has admittedly made and sold *four* designs of bulkhead installations which Evans charges are infringements of the patent in suit. These are designated by Preco as its Models BD-6, BD-2, BC-4 and BC-3. Each of these four models manufactured and sold by Preco is charged to infringe all three claims of the patent in suit. Model BD-6 is shown in the photographs DX AN 1 to 6 and the three other models are shown in the charts DX AA to AF, inclusive.

In addition, Preco filed an interrogatory (PX 35—No. 17) which stated that a fifth design, Model BE-2, had been made by Preco and asked whether Evans considered it to be an infringement. Evans replied in the affirmative (PX 36—No. 17). It later developed that Model BE-2 (which is shown in charts DX Y and Z) was experimental, had never been installed in a freight car and had never been sold (TR. 247 and DX AQ Interrogatory 17 and Answer). In view of the facts, it is believed that Model BE-2 is of little importance and does not justify the Court's time in considering and passing upon it. The findings and conclusions regarding it should be vacated on the ground that it is *de minimis.*

1) Models BD-6 and BD-2—Full Width Bulkheads

These two bulkheads for the present purposes are substantially the same (TR. 130) with a single exception which will be pointed out later and accordingly, the following description of Model BD-2 as shown in the charts DX AE-1*, and AE-2 and AF* and explained by witnesses, may be considered applicable to both.

The bulkhead or partition 40 is suspended from a transverse bar 42 which is channel-shaped as shown in cross section in the lower left-hand view of DX AF and which is supported at its opposite ends by rollers 48 which roll along rails or tracks 32 and 34 which are formed of two angles welded together to form a C-shaped cross section which

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* For convenience of reference, conformed copies of DX AN-2, DX AE-1 and DX AF are reproduced in the Appendix hereto.

extends the full length of the car.* In the Model BD-6 these rails are mounted directly on the side walls (Finding of Fact No. 33, R. 396), as best shown in the photograph DX AN-6 and as admitted by Preco (TR. 130, 248), whereas in the Model BD-2 the rails are bolted to a ceiling truss which extends across the car and is supported on the side walls (TR. 233, 237, 1101). Thus, the only difference in these Models BD-6 and BD-2 is in the way the rails are mounted (TR 130) and this difference boils down to the manner in which the rails are supported on the side walls. In Model BD-6 they are supported on the side walls by brackets which are welded to the rail and the side wall posts. In Model BD-2 they are supported on the side walls by ceiling trusses which are bolted to the rails and rest on the side walls.

The bulkhead 40 is suspended from the transverse bar 42 by a bracket or hanger 54 which is provided with rollers 62 which roll along the transverse bar 42 and the bracket 54 carries a vertical axis pivot pin 52 which suspends the bulkhead over its center of gravity so that the bulkhead may be rotated about this vertical axis from a position transverse with respect to the car to a position longitudinal with respect to the car. The bulkhead may be moved transversely of the car by moving the bracket 54 along the transverse bar 42.

The bulkhead 40 is provided with lockpins 80 at each corner which move vertically and engage in openings 104 which are fixed with reference to the body of the car, to lock the bulkhead in position independently of the transverse bar 42. The openings engaged by the upper locking pins 80 are formed in horizontal flanges comprising the lower parts of the rails 32 and 34 which constitute the supporting tracks for the transverse bar 42.

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* The charts DX AE-1, AE-2 and AF incorrectly illustrate the upper arm or flange of the C section as interrupted. It is stipulated (DX AR) that the charts are to be considered corrected to show that the upper angle of the rail also extends the full length of the car.

The foregoing description of the Preco Models BD-6 and BD-2 is equally applicable to the Evans DF-B bulkhead equipment which Evans claims embodies the invention of the patent in suit and which Evans has marketed since 1959 (TR. 164-5). In the Evans DF-B bulkhead equipment, which is illustrated in the Evans' brochure DX AG (TR. 157), the rails, as in the Preco Model BD-6, are secured directly to the side walls (TR. 484).

From a comparison of Preco's Models BD-6 and BD-2 with the essential features of the patent in suit, it will be seen that these models incorporate all of these essential features and embody the improvement in the art taught by the patent in suit. Thus, each of these models (BD-6 and BD-2) employs a bulkhead suspended from a transverse bar in a vehicle body by a connection which is movable along the length of the bar and which provides for pivotal movement of the bulkhead about a vertical axis. Each also includes rails on which the ends of the bar are supported to permit movement of the transverse bar on the rails along the length of the vehicle body. And finally, each of Models BD-6 and BD-2 has means for latching the bulkhead to the vehicle body in a plurality of positions along the length of the vehicle.

The Evans construction, as well as the accused Preco constructions, embody a feature known as a "timing shaft" or a "squaring shaft" which is not found in the Wells patent and which has been seized upon by Preco to create confusion respecting the question of infringement, and which, therefore, should be described briefly. The function of this device is to keep the transverse beam or bar 42 at right angles to the side walls as it moves along the length of the car. The provision of such means is necessary when a bulkhead is mounted in a boxcar because in such an in-

stallation the transverse beam is too high to reach and thus will tend to cock because it cannot be guided by hand. In a highway truck installation such as that chosen as the illustrative embodiment of the invention in the Wells patent, no such means is required (TR. 804-806).

The means to prevent cocking utilized by both parties in their commercial constructions is an old expedient in the bulkhead art* namely, to connect the wheels at the opposite ends of the transverse bar by a shaft so that the wheels are compelled to rotate in unison. Teeth are provided on the wheels and mesh with openings in the supporting tracks to prevent slipping. This arrangement insures that one end of the transverse bar cannot move longitudinally of the car in advance of the other.

This connecting shaft, which is called a squaring shaft or a timing shaft, has nothing to do with the invention of the patent in suit. While the provision of some means to prevent cocking is desirable even in a truck installation, and probably necessary when an installation is made in a boxcar, they are known expedients in the art available for use when desired.

2) Accused Model BC-3

This model, which is illustrated in the charts DX AA and DX AB,** differs from the previously discussed Model BD-2 primarily in that it is a half-width bulkhead which is used in pairs to span the width of the boxcar. It also employs a track which is L-shape in cross section as dis-

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* See the patent to Moriarity 1,388,819 of 1921 (PX 2-D) and TR. 588-590 and 607-8.

** For convenience of reference, a conformed copy of DX AB is reproduced in the Appendix hereto.

tinguished from the C section tracks of Models BD-2 and BD-6, and it has a modified design of transverse bar 42 which is tubular and the supporting bracket 54 embraces the bar which represents a mere reversal of parts as compared with the structure of the Wells patent.

3) Accused Model BC-4

Model BC-4 is illustrated in the charts DX AC* and AD. It is similar to the BC-4 model in that it is a half-width bulkhead and the tracks are L-shape in cross section rather than C-shape as specified in Claims 2 and 3. However, it is more nearly like the Wells patent in other respects than is Model BC-3. Thus, Preco has admitted that the transverse bar 42 of Model BC-4 satisfies the terms of the claims of the patent in suit (TR. 1229).

4) Model BE-2

Model BE-2 is shown in illustrations DX Y and Z. This is the model which was experimental, was never installed in a freight car and has never been sold (TR. 247 and DX AQ Interrogatory 17 and answer). It is generally similar to the Model BC-3 except that the transverse bar 42 is fixed to the supporting rollers and rotates with the rollers.

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* For convenience of reference, a conformed copy of DX AC is reproduced in the Appendix hereto.

SPECIFICATION OF ERRORS

Evans relies on all of the errors of the District Court set forth in the statement of Points Upon Which Appellant Intends to Rely filed in this case (R. 409-13), but in the interest of brevity, the gist of those errors may be stated as follows:

(a) The Court erred in restricting the Wells patent to the illustrated embodiment of the invention and in giving the claim language an artificially restricted interpretation to support a holding of non-infringement.

(b) The Court, when comparing the language of the Wells patent claims with the accused constructions, erred in applying to the timing shaft of certain of the accused constructions the claim language calling for a transverse "bar" and using that misapplication of the claim to support a holding of non-infringement, when, in fact, the accused constructions incorporated another element which had the structural and functional characteristics of the "bar" specified in the claims.

(c) The Court erred in concluding that the accused structures avoided infringement because they incorporated features in addition to the combination of elements claimed by Wells when those added features did not change or impair the function and co-action of the claimed elements.

(d) The Court erred in concluding that the file wrapper of a subsequent patent obtained by Evans covering improvements over the Wells construction that are incorporated in some of Evans' commercial

constructions contained admissions by Evans supporting Preco's contentions regarding differences between the accused load dividers and the structure of the patent in suit.

(e) The Court erred in failing to hold that the Wells invention filled a long-felt need and achieved substantial commercial success.

(f) The Court erred in concluding that because elements like those specified in the claims of the Wells patent were found separately in the prior art where each functioned alone as it did in the Wells combination, that the combination claimed was an unpatentable aggregation of old elements, when in fact, they co-act to produce a useful result not hitherto achieved in the prior art.

(g) The Court erred in concluding that it would have been obvious at the time the Wells invention was made to conceive the combination of elements claimed in the patent.

(h) The Court erred in failing to hold that the Wells patent is valid and is infringed by each of the accused constructions.

SUMMARY OF ARGUMENT

The errors of the District Court are errors of law rather than fact since there are no disputed facts bearing on the questions of infringement and validity.

It is not disputed that the combination of elements disclosed and claimed in the Wells patent is novel. No one prior to Wells suspended a bulkhead by a vertical axis swivel from a trolley that was movable along the length of a transverse bar, which in turn was supported at its ends on longitudinal tracks so that it could move along the length of the transport vehicle or box car while supporting the bulkhead. That combination of elements in conjunction with means for locking the bulkhead to the vehicle body at any point along the length of the car provides a universally adjustable bulkhead which not only can be locked in load retaining position at any point along the length of the vehicle body, but can be stowed out of the way against a side wall *at any point along the length of the body* during loading and unloading and can easily and safely be operated by one man, even though it weighs well over a thousand pounds. No prior art so functioned or produced that result.

It is not disputed that the commercial "DF-B" bulkheads sold by Evans *and* the accused bulkheads sold by Preco have all of the above-stated features of the Wells patent combination.

It is not disputed that there has been a long felt need for a practical permanently mounted bulkhead in railroad box cars, and it is not disputed that Evans commercial "DF-B" bulkhead and the accused bulkheads have filled

that need and achieved remarkable commercial success, superseding all prior designs—none of which was widely used. There is no dispute as to the structure or mode of operation of either the Evans "DF-B" bulkhead or any of the accused bulkheads, the nature of which is disclosed in photographs and stipulated pictorial charts. And there is no dispute as to the existence, nature or mode of operation of the prior art relied upon by Preco, all of which is represented by prior patents.

The pivotal error of the District Court resides in an error of construction of the Wells patent claims which led to the conclusion that there was no infringement. This means, of course, that the Evans commercial bulkheads were also outside the scope of the Wells patent because they are substantially identical to accused Preco Model BD-2. That left the Wells patent in the category of a paper patent which was not entitled to the benefit of the fact that the substantially identical commercial constructions of the parties had filled a long left need. This is crucial in view of the recent decision of the Supreme Court in *Graham v. John Deere Co.*, 383 U.S. 1; 15 L. Ed. 2, 545, 556, which reaffirms the well established principle that where an invention fills a long felt need, there is a presumption that its conception was not obvious, since otherwise the need would have been filled promptly. Decisions of this Court applying this principle include *Kaakinen v. Peelers Co.*, 301 F. 2d 170 (1962); *Twentier's Research Inc. v. Hollister Inc.*, 319 F. 2d 898, 902 (1963); *Pursche v. Atlas Scraper & Engineering Co.*, 300 F. 2d 467, 474 (1961); *Neff Instrument Corp. v. Cohu Electronics Inc.*, 298 F. 2d 82, 87 (1961); *Hayes Spray Gun Co. v. E. C. Brown Co.*, 291 F. 2d 319, 322 (1961); *Stearns v. Tinker & Rasor*, 220 F. 2d 49, 58 (1955); *Pointer v. Six Wheel Corp.*, 177 F. 2d 153 (1949).

It is well settled that the construction of the claims of a patent, like that of any written instrument, is a question of law for the Court, *Hansen v. Colliver,* 282 F. 2d 66 (1960). In that case, this Court also held that (p. 69):

> "—since the facts are not in dispute the question of infringement resolves itself into one of law, depending on a comparison between the patent claim in issue and the accused device, and the correct application thereto of the law of equivalency." (citing cases)

In this case the District Court violated several principles of law in its construction of the claims of the Wells patent. First, it made an improper comparison of the claims with the accused structures by applying the term "bar" of the claims to the timing shaft rather than the bar marked 42 on the charts which illustrate the accused structures. Secondly, the District Court read unexpressed limitations into the claims, in effect, limiting the patent without justification to the specific embodiment of the invention disclosed by the patentees. This violates the principle that the question of infringement must be determined in the first instance by the language of the claim as distinguished from the illustrative embodiment of the invention disclosed. *Neff Instrument Corp v. Cohu Electronics Inc.,* 298 F. 2d 82, 88, C.A. 9, 1961, and *Graver Tank & Mfg. Co. v. Linde Air Products Co.,* 339 U.S. 605, 607, 94 L. Ed. 1097, 1101. It also violated the principle stated in the above decisions that it is improper to give a patent claim a construction so limited that the principles of the invention may be enjoyed without liability by anyone except one who copies every literal detail. And the District Court's "hypercritical reading of the claims" in this case was a clear violation of this Court's ruling in *Pursche v. Atlas Scraper & Engineering Co.,* 300 F. 2d 467 (1961), which involved a closely analogous fact situation.

The District Court also erred in failing to recognize and apply the principle that one cannot avoid infringement by incorporating improvements in his construction so long as he continues to employ the patented invention, even though these improvements may themselves be patentable. *Temco Electric Motors Co. v. Apco Mfg. Co.,* 275 U.S. 319, 328, 72 L. Ed. 298, 302; *Neff Instrument Corp. v. Cohu Electronics Inc., supra,* and *Hayes Spray Gun Co. v. E. C. Brown Co.,* 291 F. 2d 319, C.A. 9, 1961. Moreover, in this case there is no evidence that any improvements were incorporated in the accused bulkhead installations. The timing shaft feature, of the accused constructions, which was not found in the Wells combination, was known in the art before the Wells patent, as shown by the patent to Moriarity 1388819 of 1921, PX 2-D. Accordingly, at the date of the Wells patent it was in the public domain, and available to anyone for use when desired. Since it is an adjunct rather than a substitute for any part of the Wells combination, its presence or absence has no bearing on the question of infringement.

If the claims of the patent are properly construed, they read fairly upon the Evans DF-B bulkhead and also the accused constructions without the need for recourse to the doctrine of equivalents, except possibly in the case of accused Model BC-3 which embodies a reversal of parts over the structure specified in claims 2 and 3. Thus, claims 2 and 3 call for a channel-shaped transverse bar 42 with the bulkhead support movably mounted "in" the channel, and the Model BC-3 has a tubular transverse bar with the bulkhead support movably mounted on the *outside* of the bar. However, such reversals of parts do not avoid infringement where, as here, they do not change the function or result. *Oxnard Canners v. Bradley,* 194 F. 2d 655, 658, C.A. 9, 1952. In any case, the question is academic in view of the fact that claim 1 is broad enough to cover either version.

The Patent Statute 35 USC 282 provides that:

> "A patent shall be presumed valid. The burden of establishing invalidity of a patent shall rest on a party asserting it."

Preco has sought to sustain its burden by proof that elements similar to those of the Wells patent combination may be found separately in the prior art. No evidence was adduced that can be said to suggest that they might be combined as taught by Wells; and no prior art is cited in which elements of any kind coact to produce the results achieved by the patented combination.

This type of attack on a patent is a familiar one since it can be made against any and all patents on mechanical devices. It can prevail only if it fairly supports a conclusion that the invention fails to meet the requirements of Section 103 of title 35 USC, which was recently sustained by the Supreme Court as "a codification of judicial precedents"*. That section provides:

> "A patent may not be obtained though the invention is not identically disclosed or described as set forth in section 102 of this title, if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains."

But the question of "obviousness" under Section 103 is a question of law to be resolved in the light of the facts, which in this case stand uncontroverted. See the Graham case* and this Court's decision in *Elrick Rim Co. v. Reading Tire Machinery Co.*, 264 F. 2d 481, note 7 at 486 (1959).

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* *Graham v. John Deere Co. of Kansas City*, 383 U.S. 1, 15 L. Ed. 2d 545, 556.

In concluding that the Wells invention was obvious, the District Court made an error of law because it disregarded the well established principle that the validity of a patent on a new combination of elements cannot be attacked by piecing together elements found in a plurality of different prior combinations using the teachings of the patent in suit as a guide. *Goodyear Tire and Rubber Co. v. Ray-O-Vac. Co.,* 321 U.S. 275, 279, 88 L. Ed. 721, 724; *National Sponge Cushion Co. v. Rubber Corp. of Cal.,* C.A. 9, 286 F. 2d 731, 735; *The Troy Co. v. Products Research Co.,* 339 F. 2d 364, 366, C.A. 9, 1964; *No-Joint Concrete Pipe Co. v. Hanson,* 344 F. 2d 13, 14, C.A. 9, 1965; *Pursche v. Atlas Scraper & Engineering Co.,* 300 F. 2d 467, 478, C.A. 9, 1962; *Neff Instrument Corp. v. Cohu Electronics Inc.,* 298 F. 2d 82, 87, C.A. 9; *Ry-Lock Co. Ltd. v. Sears Roebuck & Co.,* 227 F. 2d 615, 618 (C.A. 9); *Coleman Co. v. Holly Mfg. Co.,* 233 F. 2d 71, 78, C.A. 9, 1956; *Pointer v. Six Wheel Corp.,* 177 F. 2d 153, 160 C.A. 9, 1949; *Payne Furnace & Supply Co. v. Williams-Wallace Co.,* 117 F. 2d 823, 826, C.A. 9, 1941.

The District Court also made an error of law in failing to give the Wells patent the benefit of the fact that it filled a long felt need. The importance of this factor in weighing the question of obviousness can hardly be exaggerated in view of the recent decision of the Supreme Court in the Graham case and the cases in this Circuit cited above at page 23.

Finally, the District Court erred in holding that the most pertinent prior art was cited in the Patent Office. Preco has offered no art disclosing the claimed combination. Not one prior patent discloses a swivel mounted on the trolley of a traveling transverse bar or beam let alone such a combination used as a suspension for a bulkhead. The best Preco can say is that the prior art relied upon shows that elements similar to those utilized in the Wells combination are found

separately in the prior art. But this was established by the prior art cited by the Patent Office.

The undisputed facts require a conclusion as a matter of law that the Wells patent is valid and has been infringed by the accused bulkhead constructions of Preco.

ARGUMENT

I. Infringement

A. In General

As can be seen from the previous descriptions of the Wells invention and the several accused constructions, the latter clearly embody every essential feature of the invention. Their structure is essentially the same as that of the patent and they function in the same way to produce the same result. This is enough to establish infringement without regard to specific claim language. However, as pointed out below, the claims are fairly applicable to the accused structure.

B. Preco Models BD-6 and BD-2

1. The Claims Read in Terms Upon Preco Models BD-6 and BD-2

The typed statements on claim charts (DX AZ-1, 2 and 3)* which set forth the gist of the testimony of Evans'

* These claim charts were originally attached to Evans' trial brief but during the trial the Preco expert, Chestnut, wrote the word "No" in red on the statements with which he disagreed (TR. 1099-1104, 1113-1130, 1145-46). By agreement, these charts were then received in evidence as DX AZ-1, 2 and 3 to illustrate the positions of the parties (TR. 1233-1236 and 1243-44), and they are referred to for that purpose in the District Court's findings. For convenience of reference, conformed copies of these claim charts DX AZ-1, 2 and 3 are reproduced in the Appendix hereto.

expert witness Nickerson (Tr. 600-666) clearly show how the language of the three claims of the patent in suit, which is set out under column one, reads on the structure disclosed in the patent in suit (see column 2). In column three these charts show how the claim language reads, in the same sense, on the accused Model BD-2, which is illustrated in the charts DX AE-1, AE-2 and AF. This third column is equally applicable to Model BD-6, and in fact, the clause (e) of Claim 1 and (d) of Claims 2 and 3 find an even more direct response in Model BD-6 where the rails are *admittedly* mounted directly on and carried by the side walls (TR. 130, 248).

2. The District Court was Misled by Preco's Gross Misapplication of the Claim Language

Preco has sought to evade the consequences of the clear readability of these claims on the accused devices by intentionally misapplying the claims to the accused structures and by entirely distorting the claims. This has been done by intentionally selecting the wrong part of the accused structure on which to read a critical part of the claim. Specifically, the language "bar" of Claim 1 or "transverse bar, channel-shape in cross section" of Claims 2 and 3 is said by Preco to refer to the timing shaft, whereas it should be applied to the transverse bar 42 of the accused structures (TR. 1103, 1104, 1118, 1121).

3. Claim 1

If the transverse channel shaped member 42 in the accused Model BD-2 (DX AE-1, AE-2 and AF) is considered the "bar" specified in the clause of Claim 1, which is designated (g) in claim chart AZ-1, as it obviously should, then the remainder of the claim is clearly applicable to the accused Model BD-2. However, Preco's expert witness

Chestnut, by misapplying the term "bar" to the timing shaft of the accused construction instead of the transverse bar 42, had no difficulty in finding that other language of the claim did not fit. Thus, he testified that the clause in Claim 1 which is designated (j) in the claim chart and which specifies a pivotal connection between the partition and the "bar" was not readable because the accused construction lacked a pivotal connection *to the timing shaft* (TR. 1115-16), although it obviously had such a connection to the transvers bar 42. Similarly, he testified that the clause (k) which calls for means slidably mounting the pivotal connection on the bar was lacking because the corresponding means in the accused construction did not slidably mount the pivotal connection *on the timing shaft* (TR. 1117), although it obviously did so mount the connection on the transverse bar 42. This ridiculous house of cards collapses in its entirety if the term "bar" is applied to the channel shaped member 42 of the accused construction.

It is difficult to see how the District Court could have been deluded by such transparent artifice. This is particularly so since Chestnut's house of cards was built on the premise that the "bar" of the claim *had* to be applied to the timing shaft of the accused device, and yet at the same time he testified that it could *not* be applied to the timing shaft because the timing shaft was not "slidably mounted on the rails" as required of the "bar" specified in the claim (TR. 1103-4), although it is not disputed that the transverse bar 42 of the accused construction is "slidably mounted on the rails" (TR. 1104, 1177, 1226-27, 1229-30, 1233).

The *sole* ground on which Chestnut justified his refusal to apply the term "bar" to the member 42 of the accused

Model BD-2 was that it was not "supported by the rails" (TR. 1228-9). This is an obvious error, since the entire weight of the transverse bar 42 and the associated bulkhead of the accused Model BD-2 rests on the rails through the supporting wheels or rollers 48. The transverse bars 42 of both the Wells patent and the accused Model BD-2 are supported on the rails by rollers mounted at the ends of the bar. The only difference between them is that the accused Model BD-2 the supporting rollers are connected by a shaft (the "timing shaft") so that they will rotate in unison. It was Chestnut's theory that the channel-shaped bar 42 of the accused BD-2 construction was supported on the timing shaft on which the supporting rollers 48 are mounted rather than on the rails, but since the timing shaft is admittedly supported on the rails (TR. 1104), the rails necessarily support everything mounted on the timing shaft, including the transverse bar 42.

It is submitted that the entire testimony of Preco's expert Chestnut, is completely discredited by this patently fallacious testimony. Moreover, the fact that Preco continued to urge this position is a measure of the lengths to which it feels it must go to escape a judgment of infringement. Finally, the fact that the District Court adopted wholesale this distorted view (Finding No. 32, R. 395) indicates a failure on the part of the District Court to understand the relatively simple mechanisms involved in this case.

Preco seeks to escape the reading of other clauses of Claim 1 on Model BD-2 by a hypercritical reading of the claim. Clause (d) recites a row of detents carried by at least one of the walls and clause (e) recites oppositely disposed rails carried by said walls. The contention of Preco that these clauses do not read on Model BD-2 is based solely

on the assertion that the rails and detents are not "carried by the walls" (TR. 1245). This contention is not applicable to the Model BD-6 for there the rails are admittedly mounted directly on the side wall posts (TR. 130, 248) and therefore, the rails as well as the row of detents formed therein are clearly carried by the walls.

The Model BD-2 differs from the Model BD-6 only in that rails 32 and 34, rather than being secured to the side walls by brackets welded to the side wall posts, are secured to the side wall structure through horizontal ceiling trusses to which they are bolted and the ends of which are supported on a longitudinally extending wood beam which is secured to the eave plate or side plate, which is the top of the side wall at the junction between the side wall and the roof (Konrad TR. 233). The weight of the track, which is bolted to the truss, is carried by the side wall construction (Konrad TR. 237). As explained by Mr. Amig, who was deeply involved with freight car construction throughout a lifetime with The Pennsylvania Railroad, the side wall of a boxcar or refrigerator car consists of the side sill at the bottom, the posts, the outside sheets, the lining and the top side plate (TR. 493-4).

The claim language here under consideration requires only that the rails and a row of detents be "carried by" the walls and does not require connection *directly* to the side wall with no intermediate parts. Even Preco recognizes that this language reads on Model BD-6 although there the rail is connected to the side wall post through the parts best shown in the photograph DX AN-6 which was taken after these connecting parts had been chalked to better show in the photograph. Clearly, it makes no difference whether the rails are connected to the side wall through these connecting parts or as in Model BD-2 through a truss which is connected to and carried by the side wall.

This very type of hypercritical reading of the claims was rejected by this Court in *Pursche v. Atlas Scraper & Engineering Co.*, 300 F. 2d 467 (1962). The patent there involved related to a plow and it was argued that two of the claims were misdescriptive because they described the lift means for raising and lowering the plow share carrier as "connected with the cross member" of the plow frame, whereas the drawing showed the lift means attached to the side members of the frame. This Court stated, pages 478-9:

> "We think the argument is not only patently tenuous but requires a hypercritical reading of the claims. If by 'lift means' Pursche meant the device that serves to raise the carrier rather than the mode of performing the raising and lowering function, nevertheless the 'lift means' are attached to the side members of the frame of the plow and these side members in turn are attached to the cross-member designated in the two claims. Although the 'lifting means' are not directly connected to the cross-member they are joined to it by that intermediate connection, and are therefore 'connected with the cross member'.
>
> "Moreover, as a legal proposition the argument is likewise unsound; every embodiment of an invention need not be described in the specifications nor illustrated by the drawings in a patent so long as the form of the device is not the principle of the invention.
>
> > " 'It is enough if the invention be described together with that mode which is conceived to be the best for putting it into practical use; and where that has been done, the patent is not confined to the precise mode outlined.' *Chicago Pneumatic Tool Co. v. Hughes Tool Co.*, 97 F. 2d 945, 946 (10th Cir. 1938); see also, *Cameron Iron Works v. Stekoll*, 242 F. 2d 17, 20 (5th Cir. 1957).

"Conversely stated, the claims need not set out the exact same structures as are shown in the drawing or described in the specifications so long as the differences between them do not encompass the invention itself.

"The essential features of the invention are stated whether the 'lifting means' is directly or remotely connected to the cross-member."

This same argument, that the detents are not carried by the side wall, is the sole basis for the denial that clause (1) of Claim 1 reads on the Model BD-2 (TR. 1252) and accordingly, this denial also is unwarranted.

The only remaining clauses of Claim 1 (as shown on the chart DX AZ-1) which Preco contends do not read on Model BD-2 are clauses (f))and (h). The contention with respect to clause (f) is that the rails are not located above the upper row of detents. Mr. Chesnut, the expert witness for Preco admitted that it didn't make any difference how close the upper row of detents was to the rail (TR 1222). In the Model BD-2 construction the supporting function of the rails 32 and 34 is performed by the upper surface of a horizontal flange at the bottom of the rail. The row of detents is in this bottom flange, the holes thereof extending downwardly from and therefore are below the supporting surface of the rail. It is respectfully submitted that, having in mind the principle of claim interpretation that it is the duty of the Court to construe the claims so as to give effect to the grant rather than to destroy it, clause (f) may be fairly read on Model BD-2.

Clause (h) recites that the rails are constructed for guiding the movement of the transverse bar longitudinally of the rails. In both the patent in suit and in the accused Model BD-2 the rails guide the transverse bar during such movement by restraining it to movement in a horizontal

plane, which is done by providing a horizontal planar surface on each rail which supports one end of the transverse bar during such movement. Preco's expert, Mr. Chestnut, in testifying regarding the prior art Dixon patent (PX 2-N) stated that keeping the bar in a horizontal level plane is a guiding function and he further admitted that the claims don't specify any particular guiding function (TR. 1181). Also, in both the patent in suit and in Model BD-2 the rail co-operates with the transverse bar and guides it to restrain movement of the transverse bar transversely of the track. Preco's witness, Mr. Beemer, who was chief engineer and vice president in charge of engineering during the development of the accused devices, admitted that the rail co-operates wtih the sprockets to prevent slippage of the transverse bar, both longitudinally of the rail and transversely of the rail (TR. 443). This testomony of Messrs. Chestnut and Beemer confirms that of Evans' expert Mr. Nickerson, leaving the evidence undisputed that in the accused Model BD-2, the rails are constructed for guiding the movement of the transverse bar along the length of the rails.

The decision of this Court in *Hansen v. Colliver,* 282 F. 2d 66 (1960) is particularly pertinent here. The patent there related to means for interchanging the cores in wire ropes and the claim recited a stationary support having a guide through which the rope is drawn. While the guide disclosed in the patent there in suit was tubular, the table top guide in the device there accused was held to be an equivalent. In so holding, the court pointed out that the guide mentioned in the claim is not amplified therein, its form and shape is not specified; and that the general statement of the invention makes no specific reference either to the guide sleeve or to its form. The Court stated, pages 68-69.

> "Claim 1 does not describe that the rope shall be guided by any particular means or that the guide be of any prescribed shape or form. It appears to us that the limitation of claim 1 by the trial court to a tubular or enclosed guide is contrary to the well established rule of construction that a broad claim will not be construed to contain limitations expressed in the more narrow claims. *Smith v. Snow* (1935), 294 U.S. 1, * * *"
>
> "In our view the proper construction of claim 1 requires a 'guide' but does not require a guide of any specified shape or form or that the rope shall be guided by any particular means. While we are inclined to disagree with the view of the district court that the table top of appellees' device is not a guide and therefore does not literally infringe appellant's patent, we are wholly satisfied that the undisputed facts compel the application to this case of the doctrine of equivalents. The doctrine is applicable if the accused device performs substantially the same function in substantially the same way to obtain the same result as that claimed for the patented device, *Sanitary Refrigeration Co. v. Winters* (1929), 280 U.S. 30, 42, 3 USPQ 40, 44; *Graver Mfg. Co. v. Linde Co.,* (1950), 339 U.S. 605, 85 USPQ 328."

These arguments by Preco adopted by the District Court amount to limiting the claims to the specific embodiment shown in the patent in suit. Since this is neither required by the claim language nor required to avoid the prior art, this is clearly improper. This is clearly stated by the Supreme Court in *Smith v. Snow,* 294 U.S. 1, 11, 79 L. Ed. 721, 728.

> "We may take it that, as the statute requires, the specifications just detailed show a way of using the inventor's method, and that he conceived that particular way described was the best one. But he is

> not confined to that particular mode of use since the claims of the patent, not its specifications, measure the invention."

This rule was applied by this Court in *Hayes Spray Gun Co. v. E. C. Brown Co.,* 291 F. 2d 319, 326-7 (C.A. 9) 1961.

It will thus be seen that when Claim 1 is properly construed it clearly reads upon and is infringed by the construction of the accused Model BD-2 and that *a fortiori* the same is true of Model BD-6. The District Court not only accepted these fallacious arguments by Preco, but it blindly adopted Finding of Fact 32 submitted by Preco which included, along with the above discussed clauses (d), (e), (f), (g), (h), (j), (k) and (l), clause (i) and by so doing the Court found as a fact that Preco's Model BD-2 does not include "a partition member". The contentions of Preco never went this far and this is clearly error.

Accordingly, there is no basis whatever for the District Court's adoption of the Preco denials that the language of Claim 1 is applicable to accused Models BD-2 and BD-6 and therefore, these models clearly infringe Claim 1.

4. Claim 2

What has been said above with reference to Claim 1 is also generally applicable to Preco's contention that Claim 2 does not read on the accused Model BD-2, all of which were adpoted by the District Court. Specifically, when clause (e) (referring to the claim chart DX AZ-2) is properly construed as reading on the transverse bar 42 rather than the timing shaft, the basis for Preco's denial that clauses (e), (f), (h), (i) and (j) read on Model BD-2, vanishes.

The clauses of Claim 2 which remain to be considered are clause (c) which recites that the tracks are C-shape in cross section, clause (d) which adds that they are carried by the upper parts of the side walls, and clause (k) relating to the locking means.

With respect to clause (c), the rails or tracks 32 and 34 in Model BD-2 are formed of two full length angles (see stipulation DX AR) which are welded together to form a C-shape. Accordingly, there is no basis whatever for a denial that the accused Model BD-2 has "tracks, C-shape in cross section".

In this connection the chart DX AZ-2 states in the third column with reference to the tracks of Model BD-2, that they are L-shape in cross section. This is the error that was corrected by the stipulation DX AR.

The rails are carried by the upper parts of the side walls as called for in clause (d), as pointed out above in considering clause (e) of Claim 1.

Clause (k) specifies that the locking means are "on an edge" of the partition and "engage a side wall of the vehicle body." In the Wells patent structure the locking means are bolts or pins 80 which engage in holes in bars 100 and 102 which are not normal parts of the side wall but are secured to the usual stake truck side wall. The locking pins 80 at the top edge of the Model BD-2 bulkhead engage the lower flange of the tracks 32 and 34 which are fixed with respect to and are carried by the side walls 18 and 20 and it is believed that this is the full equivalent of the locking means recited in clause (k) positioned to engage a side wall. Claim 2 thus clearly reads on Model BD-2 and

therefore, also on Model BD-6. In addition, the locking pins 80 at the bottom of the Model BD-2 bulkhead engage floor detents positioned adjacent the side walls. This is an obvious equivalent of an engagement with the wall.

Accordingly, there is no basis whatever for the District Court's adoption of the Preco denials that the language of Claim 2 is applicable to accused Model BD-2 and BD-6 and therefore, those models clearly infringe Claim 2.

5. Claim 3

Referring to the claim chart DX AZ-3, here, again, when clause (e) is read on the transverse bar 42 it is seen that there is no longer any basis for Preco's denial that clauses (e), (h) and (j) read on the Model BD-2, and yet again, all of Preco's denials were adopted by the District Court. Also, as in the case of Claim 2, when it is considered that the tracks are two angles welded together, and it is appreciated that both angles are continuous (stipulated in DX AR), it is apparent that the tracks are clearly C-shaped. There is, thus, no proper basis for Preco denying that clause (c) reads upon Model BD-2 and since this denial was the basis for denial with respect to clause (f), (TR. 1254-55), there is clearly no proper basis for that denial.

The denial with respect to clause (k) is based on Preco's claim that its latch bolts are not mounted in side edges. The claim clearly is not limited to *side* edge mounting, saying broadly, "latch bolts slidably mounted in the edges". This clause reads directly on Model BD-2 and in any event, latch bolts at the corners are the full equivalent of latch bolts in the side edges. Accordingly, the denial with respect to clause (k) is improper and it clearly reads on Model BD-2.

The denial by Preco that clauses (l), (m), (n) and (o) read on Model BD-2 is based on the denial that clause (k) reads on Model BD-2 and a bare assertion that the structures are different (TR. 1122, 1123, 1255-7), and each of these denials is therefore also improper in view of the fact that they do have in common the features specified in the claim. The difference, for example, of having one handle in place of the two of the patent in suit does not avoid infringement. This is clearly stated in *No-Joint Concrete Pipe Co. v. Hanson,* 344 F. 2d 13 (C.A. 9) 1965, at page 15,

> "A substantial body of law recognizes that infringement is not avoided by making into one part that which has been shown as two. (citing cases)."

Clause (d) of Claim 3 relates to the tracks being carried by the side walls and Preco's denial that this clause reads on Model BD-2 is clearly wrong for the reasons stated at length in considering Claim 1, clause (e).

Accordingly, there is no basis whatever for the court's adoption of the denials by Preco that Claim 3 reads on the Models BD-2 and BD-6 and therefore, Model BD-2 and Model BD-6 clearly infringe Claim 3.

By these arguments Preco led the District Court into clear error in its findings and conclusions regarding infringement.

When the claims are properly construed and applied, the following language from *Intricate Metal Products Inc. v. Schneider* 324 F. 2d 555 (C.A. 9) 1963, is also applicable here, page 559,

> "If, in any minor respect it may be said that the elements of the accused device differ from those of the claims, nevertheless the two devices are so sub-

stantially identical in function, method, and result that the doctrine of equivalents clearly applies in favor of the appellees."

6. The Errors of the District Court as to Infringement Are Errors of Law

From the foregoing it is clear that the District Court has improperly construed the patent claims by limiting them to the specific embodiment of the invention illustrated and described in the patent. This is clearly an error of law. *Hansen v. Colliver,* C.A. 9 (1960) 282 F. 2d 66.

In making this error the District Court was blinded by the differences between the embodiment illustrated and described in the Wells patent and the commercial structures of the parties, and failed to recognize that these structures have filled a long-felt need and achieved commercial success *because common to all of them is the new combination of elements claimed in the Wells patent.*

The differences which exist between Preco's Model BD-2 and its Model BD-6, on the one hand, and the embodiment of the Wells *et al.* invention disclosed in the Wells *et al.* patent in suit, either are differences which result from embodying the Wells et al invention in bulkhead equipment for use in a railroad freight car, which was contemplated by Wells et al, as pointed out above and in the specification of the patent in suit (DX A column 1, lines 1-5), or are differences which result from the addition of improvements. In either event, the differences do not avoid infringement. It is an elementary principle of patent law that it is the claims of a patent which are infringed and that the scope of a patent claim is determined in the first instance by the language of the claim. *Neff Instrument Corporation v. Cohu Electronics Inc.,* 298 F. 2d 82, 88

(C.A. 9—1961); *Graver Tank & Mfg. Co. v. Linde Air Products Co.,* 339 U.S. 605, 607, 94 L. Ed. 1097, 1101. The above mentioned differences between the Models BD-2 and BD-6 and the embodiment of the Wells et al invention disclosed in the Wells et al patent do not in any way prevent a clear reading of the claims of the Wells et al patent upon Models BD-2 and BD-6 and therefore, in no way negatives infringement.

It also appears that the District Court felt that the incorporation in the commercial structures of improvements over the basic Wells construction reflected adversely on the Wells patent. The reverse is true. It is only the most useful inventions that prompt the tribute of improvement by subsequent inventors. It would be safe to guess that thousands of patents have been granted covering improvements in the basic telephone invention of Alexander Graham Bell and yet our present highly refined telephone system employs Bell's invention and would infringe his patent if it were not expired.

It is a well settled principle of patent law that one who employs all of the features of a patented invention does not avoid infringement by reason of the fact that he has improved the invention or added other features to it. This was stated by the Supreme Court in *Temco Electric Motor Co. v. Apco Mfg. Co.,* 275 U.S. 319, 328, 72 L. Ed. 298, 302:

> "It is well established that an improver can not appropriate the basic patent of another and that the improver without a license is an infringer and may be sued as such. * * *
>
> "* * * We must consider that the Storrie patent was really an appropriation of the original design of the Thompson patent, whether it be as we think it was, a patentable improvement thereon, or the mere equivalent of the casing and hanger."

This principle was followed by this Court in *Neff Instrument Corp v. Cohu Electronics Inc., supra,* at page 89; *Hayes Spray Gun Co. v. E. C. Brown Company,* 291 F. 2d 319, 326 (C.A. 9—1961). Thus, for example, infringement is not avoided by the addition in the Preco Models BD-2 and BD-6 of the timing shaft feature, which is also em ployed in the Evans DF-B bulkhead equipment which has been on the market since 1959 and which embodies the invention of the Wells et al patent in suit. While the addition of this feature prevents the transverse bar from becoming cocked by one end advancing along the car ahead of the other, and while this is desirable when the Wells et al invention is embodied in a bulkhead for installation in a railroad boxcar, it in no way avoids infringement. Similarly, neither the addition in Preco's Models BD-2 and BD-6 of the feature of supporting the bulkhead directly on the floor through shoulders on the lower locking pins when the bulkhead is in locked position, to relieve the load on the transverse bar, nor the addition of the feature enabling the locking of the bulkhead when it is positioned against the side wall, in any way avoids infringement.

The contentions of Preco that there are differences which negative infringement are typical of the contentions commonly made by infringers who usually can point to differences. As stated by the Supreme Court in *Graver Tank Co. v. Linde Air Products Co., supra,* at 339 U.S., pp. 607-608,

> "But courts have also recognized that to permit imitation of a patented invention which does not copy every literal detail would be to convert the protection of the patent grant into a hollow and useless thing. Such a limitation would leave room for —indeed encourage—the unscrupulous copyist to make unimportant and insubstantial changes and

substitutions in the patent which, though adding nothing, would be enough to take the copied matter outside the claim, and hence outside the reach of law. One who seeks to pirate an invention, like one who seeks to pirate a copyrighted book or play, may be expected to introduce minor variations to conceal and shelter the piracy. Outright and forthright duplication is a dull and very rare type of infringement. To prohibit no other would place the inventor at the mercy of verbalism and would be subordinating substance to form. It would deprive him of the benefit of his invention and would foster concealment rather than disclosure of inventions, which is one of the primary purposes of the patent system.

"The doctrine of equivalents evolved in response to this experience. The essence of the doctrine is that one may not practice a fraud on a patent."

The District Court found (Finding No. 42, R. 399) that the contentions of Preco regarding the differences between the accused structures and the embodiment of the Wells et al patent shown therein, were supported by the admissions in the file wrapper (PX 59) of Evans' Patent No. 3,209,707. The statements to which attention was directed during the cross examination of Mr. Moorhead all appear in arguments of counsel to the effect that the claims presented therein are improvements over the prior art, including the Wells et al patent here in suit. Clearly, the arguments that the structure of Patent No. 3,209,707 involves improvements over the teaching of the Wells et al patent are in no way an admission that the structure of 3,209,707, or any of the accused structures, does not employ the invention of and is not an infringement of the Wells et al patent. Even the granting of Patent No. 3,209,707, while it results in a presumption that the invention claimed therein is valid, does not give rise to any presumption that the structure thereof

does not infringe the Wells patent in suit. *Pursche v. Atlas Scraper & Engineering Co.*, 300 F. 2d 467, 482 n. 18, (C.A. 9). The claims in support of which these arguments were made were directed to details not shown in the Wells et al patent, but the structure disclosed in 3,209,707 clearly embodies the invention of and infringes the Wells et al patent.

It is believed that this Finding No. 42 was clearly erroneous both because the arguments in no way indicate that the accused structures do not infringe the Wells et al patent and because in any event, this type of thing is not a proper admission against interest and should properly have been excluded as was done in *Catalin Corp. of America v. Catalazuli Mfg. Co.*, 79 F. 2d 593 (C.A. 2) 1935, where the court stated, page 597,

> "There remains only the judge's refusal to admit in evidence a patent to one, Pantke, owned by the plaintiff, but issued later than the patent in suit. During its prosecution the solicitor made declarations which the defendant wished to use as admissions against interest, thus entangling the patent in suit not only in all that that solicitor might say who secured it, but in whatever another solicitor might say in securing another patent for the same client. Certainly it is an answer to this that such declarations should not charge the patentee at all. When an inventor retains a solicitor, the solicitor's declarations no doubt do charge him when relevant, so far as concerns the issuance of that patent; his retainer implies that that solicitor may in reason do what he thinks best to secure it. With equal certainty it does not imply a like authority to affect a patent already granted even to the same inventor. The solicitor has no warrant for assuming that to secure the new patent his client would wish to throw doubt upon the validity of the first, or to limit its

scope. The judge was therefore right so far as any declarations in the file wrapper of the Pantke patent went."

7. There is No File Wrapper Estoppel

This is not a proper case for the application of the principle of file wrapper estoppel. Preco argued and the District Court held that by virtue of the amendment of Claim 1 of the patent in suit, cancelling the word "movable" and substituting "slidably mounted on said rails", Claim 1 is limited by the principle of file wrapper estoppel to a structure in which the transverse bar is slidable and cannot be construed to cover a transverse rotatable bar. At the outset, it should be noted that even assuming this holding to be correct, it has no application to the question of infringement of Claim 1 by Models BD-6, BD-2, BC-3 and BC-4 when clause (g) of Claim 1 (see DX AZ-1) is properly construed, as pointed out above, to read on the transverse bar 42 rather than the timing shaft, for in each of these models the transverse bar 42 does not rotate. It is not disputed that bar 42 is slidably mounted (see p. 30).

Only in Model BE-2, which was never sold or put in a freight car, as pointed out above, does the transverse bar 42 rotate. While it is believed that this model should be disposed of as controlled by the *de minimis* doctrine, if the Court chooses to pass on the merits of the infringement by this model, it is submitted the holding of the District Court of file wrapper estoppel is clearly erroneous. The doctrine of file wrapper estoppel dictates that one whose claim is rejected on prior art and who amends his claim to distinguish over such prior art, cannot after issuance of his patent give his claim as amended, a construction which would read on the prior art over which he sought to distinguish by amendment. In the present case Claim 1 was rejected

(PX 1, page 15) on Laffey No. 1,522,784 (PX 2-E), the examiner stating that the bar 14 which is shown in Figure 1 of Laffey as extending across the car and having its ends embedded in the side walls, could be moved to any desired position along the side walls and secured thereto. By this the examiner meant that the bar 14 could be disconnected from the walls to which it appears to be secured in fixed position and carried by hand or otherwise to a new location. Evans cannot now, after the amendment of Claim 1 to distinguish from Laffey, give this amended language of Claim 1 a construction which would read on Laffey, but no further limited construction is required by the doctrine of file wrapper estoppel. The language "slidably mounted on said rails" to distinguish from Laffey need be no more limited than to mean *supported while moving on said rails,* the construction given to this language by Nickerson (TR. 606). There is nothing in the rejection on Laffey which justifies limiting the construction of this language to a transverse bar which does not rotate. Therefore, Finding No. 41, that it should be so limited is entirely unfounded and clearly erroneous, even as to the Model BE-2 construction.

C. Accused Model BC-3

Since most of the claim language is applicable to Model BC-3 in the same manner as to the Model BD-2 previously discussed, the following comments are limited to those respects in which there is any difference.

The fact that the bulkhead is only half-width does not change its structural character or mode of operation. The claims of the patent may be applied to one of the half-width bulkheads. While this means that the tracks and detents at one side edge of the bulkhead are spaced from the side

walls, they are nonetheless carried by the side walls through the ceiling trusses.

Whereas the rails or tracks in the BD-2 Model were truly "C-shape in cross section", as required by limitation (c) of Claims 2 and 3, those in Model BC-3 are more accurately described as L-shape in cross section since the upper horizontal leg is not continuous but consists of a series of spaced angle brackets. This is an immaterial difference in form since it has no bearing on the function of the track. Moreover, the difference in form is slight. As pointed out in the testimony of Nickerson, the L-shape track performs all of the functions of a C-shape track in substantially the same manner (TR. 623-4 and 638) and can be considered a crude form of C. There is nothing in the prior art to require a narrow limitation of this expression. In fact, there is no novelty in the C-shape track since it is found in the prior patent to Harris, No. 1,825,452, PX 2-J.

Accordingly, to construe limitation (c) of Claims 2 and 3 so narrowly as to find no infringement based on a difference between the form of the track in the Model BC-3 and that of the Wells patent was clear error. That same error extends to the holding that limitation (f) in Claim 3 is not applicable to the BC-3 Model, because the sole basis on which that limitation was alleged to fail to read on the Model BC-3 was that that model lacked a C-shape track (TR. 1254-5). It would also extend to the similar holding as to limitation (f) of Claim 2, for which there is no supporting testimony other than the bare unexplained entry of the word "No" on the chart, DX AZ-2.

In Model BC-3 the transverse bar 42 is tubular and the supporting bracket embraces the transverse bar. This is a simple reversal of parts from the construction shown in

the patent in which the channel-shaped transverse bar embraces the supporting bracket 54. Claim 1 is broad enough in terms to cover this aspect of the Model BC-3 construction, but Claims 2 and 3 specify (e) that the transverse bar is channel-shape in cross section and (i) that means are provided for movably mounting the bracket "in the bar". There is nonetheless, infringement of Claims 2 and 3 also because it is well established that a mere reversal of parts does not avoid infringement. See *Oxnard Canners v. Bradley,* 194 F. 2d 655 (C.A. 9, 1952) where this Court stated, page 658,

> "The transposition of parts of a machine does not avert infringement, where the parts changed continue to perform the same respective functions after the change as before."

Preco does not pretend that the reversal of parts in this instance resulted in any change in function.

D. Accused Model BC-4

This model is another half-width bulkhead but Preco admits that the transverse bar 42 of Model BC-4 satisfies the terms of the claims of the Wells patent (TR. 1229). Preco, accordingly, admits, as shown by the absence of "Noes" on DX AX-1 that clauses (g), (j) and (k) of Claim 1 read on Model BC-4. Similarly, Preco admits, as shown by the absence of "Noes" on DX AZ-2, that clauses (e), (h), (i) and (j) of Claim 2 read on Model BC-4.

Consistent with the above, the District Court in Finding No. 39 did not include limitations (e), (h) and (i) of Claim 3 among those which covered features "not found in plaintiff's C-4 model".

However, the Court erroneously included limitation (j) of Claim 3 in the list of those covering features not found in the BC-4 model. This clause calls for a swivel joint suspending the partition from the bar 42. While Chestnut had aplied a "No" to this clause, in the BC-4 column of DX AZ-3, he testified that his basis for doing so was his theory that the transverse bar of the claim had to be the timing shaft (TR. 1255). Actually, he had previously testified that the "transverse bar" specified in all claims was fully satisfied by the channel-shaped bar 42 of Model BC-4 (TR. 1229) and he had not applied a "No" to the corresponding limitations (j) in Claims 1 and 2 on the claim charts DX AZ-1 and DX AZ-2 in the BC-4 column. It thus appears that the District Court has adopted an obvious mistake of the witness.

E. Model BE-2

Model BE-2 is shown in illustrations DX Y and Z. This is the model which was experimental, was never installed in a freight car and had never been sold (TR. 247 and DX AQ Interrogatory 17 and answer). There is no evidence of any intention to sell or use this or any similar construction. Accordingly, it is not believed to be of sufficient importance to justify the Court's time in considering and ruling upon it. As pointed out above, the doctrine of *de minimis* is applicable here and the findings and conclusions relating to this model should be vacated on that ground. This model was apparently made after the other models (TR. 246-47). All of the circumstances suggest that it is a red herring created for purposes of this lawsuit. If this be true, it does not represent a genuine controversy between the parties.

If, however, the Court should prefer to pass on the merits as to this model, it is submitted that it clearly infringes Claim 1 as pointed out on the claim chart DX AZ-1, and that Finding No. 37 that clauses (d), (e), (f), (g), (h), (k) and (l) are not found in Model BE-2 is clearly erroneous. These clauses, except for the omission of clause (j) are the same ones dealt with in considering the infringement of Claim 1 by Model BD-2 and BC-4 and the same reasoning is applicable here to show that these clauses read on Model BE-2. It should be further pointed out that in this model the rollers which support the transverse bar on the rail are fixed to the bar and the entire transverse bar rotates with the rollers. As pointed out in detail under the heading "There is No File Wrapper Estoppel", this is not inconsistent with the ends of the bar being slidably mounted on the rails in the sense in which this is used in Claim 1.

II. Validity

A. The Indicia of Invention

The undisputed facts, as reviewed earlier herein, demonstrate beyond any question that a very serious need existed over a long period of time for improved equipment for bracing freight in freight cars. This need is convincingly demonstrated by the claims against the railroads for damage to freight which ran into many millions of dollars every year (TR. 471). The undisputed facts further show that the railroads and the suppliers were working on this problem for many years (TR. 474 484) and that many patents have been granted on bulkhead equipment directed to this problem (PX 2, AT). Both of the parties to this case worked for many years on this problem and in particular, on the development of bulkhead equipment for railroad cars (TR. 425-7, 912).

The undisputed facts also show that when Evans brought out its first bulkhead embodying the invention of the patent in suit, which it designated its DF-B equipment, it met with an immediate and remarkable commercial success (TR. 164-66, DX AJ). Also, in addition to the large sales by Evans, the commercial success is further demonstrated by Preco's sales of the accused bulkheads and by the license under the patent in suit taken by Unarco Industries, Inc. (DX AK), a competitor in Chicago providing for a lump sum payment by Unarco, royalties to Evans, and a license to Evans under a Unarco patent, and the consent decree (DX AL) against Unarco holding the patent here in suit valid and infringed. A suit for infringement of the patent here in suit is also pending in Peoria, Illinois against Transco, Inc., a fourth competitor in this industry (TR. 828-30).

Evans had previously marketed its QL bulkhead (TR. 185, 483, 912 PX 57 A-D), but when it brought out its DF-B bulkhead, it became its first really commercially successful bulkhead (TR. 872-3). Preco, which had developed bulkheads of its own design as early as 1940 and 1941 (PX 42 A-D, 43 A-C, 44 A and B and TR. 425-27) to which Wieden Patent No. 2,360,029 (PX 2-O) related (TR. 292), and later developed its bulkhead design shown in Margarian Patent No. 3,063,388 (PX 50-A, TR. 328, 342), nevertheless paid the Wells patent in suit the compliment of marketing the accused designs embodying the invention of Wells and abandoning all prior designs. These facts, added to the marketing by Unarco of its admittedly infringing designs shown in the material attached to the agreement (DX AK) licensing it under the patent here in suit and the marketing by Transco of its bulkheads which are the subject of a suit against it by Evans for infringement of the patent here in

suit (TR. 828-30), show that the entire industry has adopted designs embodying the invention of the Wells patent here in suit.

These circumstances, the existence of a long-felt need and the commercial success of equipment embodying the invention of the patent in suit immediately after it was introduced to the industry, are strong evidence that the subject matter of the patent in suit was not obvious to one skilled in the art and that accordingly, the subject matter meets the test of patentability of Section 103, Title 35 United States Code.

The District Court was led into error in this respect by the fallacious arguments of Preco that its accused devices do not infringe and that for the same reasons the Evans DF-B equipment does not embody the invention of the Wells patent in suit. The correct application of the claims to the accused devices as set out above demonstrates that the claims are infringed by these accused devices and that the Evans DF-B equipment (see DX AG) which is substantially the same as Model BD-6 (shown in photos DX AN 1-6), also embodies the invention of the patent in suit and accordingly, the sales thereof demonstrate the commercial success of the patent in usit.

The District Court, because of this error, made no finding regarding commercial success. It made only the irrelevant finding (No. 27, R. 394) referred to earlier, that the device disclosed in the patent in suit has never been produced for commercial use, and the finding (No. 9, R. 388) that the Evans DF-B bulkhead equipment embodies the improvements of certain patents and applications other than the patent in suit. At the outset it should be pointed out that the District Court was guilty of clear error in making this finding for there is absolutely no evidence in the record that

the Evans load divider embodies the improvements of Moorhead et al, Application Serial No. 181,283, one of the applications listed in the finding. With respect to a Patent No. 3,200,773, which was also included in the finding, the only evidence (TR. 983) is that it was only in some of the extremely early versions and was not carried through to current models.

The mere fact that the commercially successful equipment of Evans embodied some variance from the structure of the patent in suit is not an indication that the commercial success is not attributable to the patent in suit and there has been no such finding here. As stated in *Binks Mfg. Co. v. Ransburg Electro-Coating Corp.*, 281 F. 2d 252 (C.A. 7) 1960, page 256,

> "The variance in structure employed in the commercial atomizing head is not indicative that the commercial success enjoyed is not attributable to the method and apparatus patent."

It should also be noted here that the evidence is that the Preco accused devices, which also evidence the commercial success, do not embody the improvements of these patents and applications (TR. 991).

The Supreme Court in *Graham v. John Deere Co. of Kansas City*, 383 U.S. 1, 15 L. Ed. 2d 545 (1966) recognized the value of objective tests of invention such as the existence of a long-felt need and commercial success because the courts are ill fitted to discharge the technological duties imposed on them by patent litigation. In considering the question of validity under the obviousness test of Section 103 of Title 35 of the United States Code, the Supreme Court referred to an article "Subtests of 'Non-obviousness'", 112 Pa. L. Rev. 1169 (June 1964).

Paraphrasing this article, the Court, referring to arguments based on long-felt need and commercial success, stated, page 566,

> "These legal inferences or subtests do focus attention on economic and motivational rather than technical issues and are, therefore, more susceptible to judicial treatment than are the highly technical facts often present in patent litigation."

The Court then cited the decision of Judge Learned Hand in *Reiner v. I. Leon Co.*, 285 F. 2d 501 (1960) where he stated, pages 503-4,

> "The test laid down is indeed misty enough. It directs us to surmise what was the range of ingenuity of a person 'having ordinary skill' in an 'art' with which we are totally unfamiliar; and we do not see how such a standard can be applied at all except by recourse to the earier work in the art, and to the general history of the means available at the time. To judge on our own that this or that new assemblage of old factors was, or was not 'obvious' is to substitute our ignorance for the acquaintance with the subject of those who were familiar with it. There are indeed some sign posts: e.g. how long did the need exist; how many tried to find the way; how long did the surrounding and accessory arts disclose the means; how immediately was the invention recognized as an answer by those who used the variant?"

The Supreme Court went on to state, p. 566,

> "Such inquiries may lend a helping hand to the judiciary which, as Mr. Justice Frankfurter observed, is most ill-fitted to discharge the technological duties cast upon it by patent legislation. *Marconi Wireless Co. v. United States*, 320 U.S. 1, 60, 57 USPQ 471, 496 (1943). They may also serve to

> 'guard against slipping into hindsight.' *Monroe Auto Equipment Co. v. Hecketlhorn Mfg. & Supply Co.,* 332 F. 2d 406, 412, 141 USPQ 549, 555 (1964), cert. denied 379 US 888, 143 USPQ 465, and to resist the temptation to read into the prior art the teachings of the invention in issue."

In the above mentioned article in the Pennsylvania Law Review referred to by the Supreme Court, the author states that a showing of both a long-felt need and commercial success presents a convincing case of patentability (112 Pa. L. Rev. 1169, 1177). The subtests or indicia of invention were utilized by this Court in *Kaakinen v. Peelers Co.*, 301 F. 2d 170 (1962). In holding valid a patent on a shrimp peeling machine, after referring to the many references relied upon the Court stated, page 173,

> "None of the evidence adduced, however, overcomes the point that where the method or device satisfied an old or recognized want, as it does here, invention will be inferred rather than the exercise of mechanical skill. 'Mere skill of the art would normally have been called into action by the generally known want.' "

The predicament of the courts and the importance of such indicia of invention was recognized by this Court in *Pointer v. Six Wheel Corp.,* 177 F. 2d 153, (1949) where it stated, page 162,

> " 'Courts', said Judge Learned Hand, 'made up of laymen as they must be, are likely either to underrate, or to overrate, the difficulties in making new and profitable discoveries in fields with which they cannot be familiar; and, so far as it is available, they had best appraise the originality involved by the circumstances which preceded, attended and succeeded the appearance of the invention. Among these will figure the length of time the art, though

> needing the invention, went without it: the number of those who sought to meet the need, and the period over which their efforts were spread: how many, if any, came upon it at about the same time, whether before or after: and—perhaps most important of all—the extent to which it superseded what had gone before.' *Safety Car Heating & Lighting Co. v. General Electric Co.,* 2 Cir., 1946, 155 F. 2d 937, 939."

Other recent decisions of this Court recognizing and applying these indicia of invention are,

> *Twentier's Research Inc. v. Hollister Incorporated,* 319 F. 2d 898, 902 (1963);
> *Pursche v. Atlas Scraper and Engineering Co.,* 300 F. 2d 467, 474 (1962);
> *Neff Instrument Corp. v. Cohu Electronics Inc.,* 298 F. 2d 82, 87 (1961);
> *Hayes Spray Gun Co. v. E. C. Brown Co.,* 291 F. 2d 319, 322 (1961);
> *National Sponge Cushion Co. v. Rubber Corp. of Cal.,* 286 F. 2d 731, 735 (1961);
> *Stearns v. Tinker & Rasor,* 220 F. 2d 49, 58 (1955).

B. The Construction of the Wells Patent in Suit Has Novelty and Utility

The utility of the invention of the patent in suit is clear from its commercial success and cannot be challenged and it is clear from the prior art that the structure claimed in the patent in suit meets the statutory requirement of novelty. While the District Court in Finding No. 12 (R. 5-6), found that all of the elements of the patent in suit are old, referring to twelve prior art patents to show that the ten

elements, as there identified, are known in the art, and while in Finding No. 13 it found that partitioning devices with many of the elements of the patent in suit were known, referring to five prior art patents, the District Court made no finding, nor did it enter any conclusion of law that the structure claimed in the patent in suit does not meet the statutory requirement of novelty.

C. The Holding of the District Court That the Invention of the Wells Patent in Suit Was Obvious Was An Erroneous Conclusion of Law

Section 103 of Title 35 United States Code requires in addition to utility and novelty, that the differences between the subject matter sought to be patented and the prior art to be such that the subject matter as a whole would not have been obvious at the time the invention was made to a person having ordinary skill in the art to which the subject matter pertains. The Supreme Court has pointed out in *Graham v. John Deere Co. of Kansas City*, 383 U.S. 1, 15 L. Ed. 545, 556 that the ultimate question of compliance with this section is a question of law and has pointed out that factual matters upon which this determination must be made are 1) the scope and content of the prior art, 2) the differences between the prior art and the claims at issue and 3) the level of ordinary skill in the pertinent art.

In a case such as the present one where the prior art consists entirely of prior United States patents, as to which there is no dispute regarding their construction and mode of operation, the scope and content of the prior art presents no factual dispute. Similarly, in such a case there is no dispute of fact as to the differences between the prior art and the claims at issue. The sole remaining question

is the level of ordinary skill in the pertinent art and the District Court made no specific finding as to this. It made only the ultimate legal determination when, in its decision (TR 1383), it held the patent in suit invalid under the doctrine of obviousness and which determination it phrased in the language of Section 103 and correctly designated Conclusion of Law No. 8 and incorrectly also designated Finding of Fact No. 24. The only other finding relating to obviousness is No. 19, which is clearly improper and irrelevant since it is couched in the present tense and does not relate to the time the invention was made as required by the statute. Thus, it is respectfully submitted that there is no finding of fact by the District Court which must be overturned by this Court for it to rule that the Wells patent in suit meets the test of unobviousness under Section 103.

As this Court stated in *Elrick Rim Co. v. Reading Tire Machinery Co.,* 264 F. 2d 481, (C.A. 9) 1959, note 7, page 486,

> "What the prior art was and what the patentee did to improve upon it are questions of fact. Whether what the patentee did is properly to be classified as an invention is a question of law."

The District Court's conclusion on the question of obviousness constituted an erroneous conclusion because:

1. It ignored the presumption of validity of 282 U.S.C. Title 35, which reads,

   > "A patent shall be presumed valid. The burden of establishing invalidity of a patent shall rest on a party asserting it."

2. It violated the principle enunciated in the decisions cited in the following section of this brief that a patent on a new and useful combination of elements

cannot be invalidated by showing that the elements are separately old in the art and by using the patent in suit as a guide to show how they might be combined to anticipate the patented combination.

3. It ignored the fact that the level of ordinary skill in the art was shown to be inadequate to conceive the patented combination by the failure of those of all levels of skill to conceive that combination in the face of a long-felt need which it satisfied.

D. The Prior Art Does Not Suggest the Wells Combination

The prior art patents relating to railroad car bulkheads show bulkheads which are mounted in a different manner than that of the patent in suit and which are incapable of functioning in the same manner or achieving the same results as the patented construction. There is no prior patent disclosing any form of bulkhead construction in which the bulkhead is suspended in equilibrium by means which permits the bulkhead to be moved easily to any transverse position along the length of the car where it can be locked directly to the car and also permits rotation of the bulkhead about a vertical axis through the suspension means and permits movement of the suspension means against a side wall of the car at any point along the length of the car for storage of the bulkhead during loading and unloading. Also, there is no prior art disclosing that it may be stored at either side of the car at any point along the length of the car.

The only other prior art relied upon, other than that relating to railroad car bulkheads, consists of patents disclosing what are known as travelling beam cranes. This is a type of crane construction which is used to lift, transport

and lower heavy loads (Chestnut TR. 1202). In all cases these cranes are equipped with a hoisting mechanism which is suspended upon a trolley which moves along the so-called travelling beam. See the prior art patents to Deady (PX 2-G), Lundborg (PX 2-S), and Staiger (PX 2-P). Also, none of the travelling beam crane prior art shows a carriage connected to the hoisting mechanism by a pivotal connection.

This travelling beam crane art is believed to be non-analogous and certainly there is nothing in the prior art that suggests that a portion of a travelling beam crane be combined with a portion of any prior bulkhead construction for any purpose, let along that they should be so combined as to create the combinations of the Wells Patent. The elements and purposes of travelling beam crane structures are believed to be so different from those found in the bulkhead art prior to the advent of the patent in suit that they would not at that time have made an appeal to the mind of a person having mechanical skill in and knowledge of the bulkhead art. Accordingly, the travelling beam crane art was at the time of the invention of the patent in suit a non-analogous art under the test set out in *Stearns v. Tinker & Rasor,* 220 F. 2d 49, 56-7, (C.A. 9) 1955. This is borne out by the fact that for many years those working in the bulkhead art did not look to the travelling beam crane art for bulkhead mountings and also, by the further fact that the Patent Office examiner working in the bulkhead art did not cite patents from the travelling beam crane art. The foregoing is equally applicable to the 1880 patent to Potter (PX 2-R) on a wooden farm gate which is clearly non-analogous art.

Even if considered, these travelling beam crane patents and the prior bulkhead patents do not render obvious the invention of the patent in suit. The only disclosure of these

travelling beam crane patents is that the carriage or trolley is used to support a hoist and there is no disclosure of a pivotal connection between the trolley and the hoist. Thus, there is no disclosure in the travelling beam crane art of record of any pivotal connection between the trolley and anything supported thereby and there is clearly no disclosure in the bulkhead art of a bulkhead connected by a pivotal connection to a trolley movable along a transverse beam mounted for movement longitudinally of the car.

Preco contends that no invention would be involved in mounting one of the prior art bulkheads on the trolley of a travelling beam crane by means of a pivotal connection which permitted rotation of the bulkhead about a vertical axis and in support of this argument, introduced three composite charts (PX 31, 32 and 40). These charts do not represent any prior art but rather, show hybrid constructions each taken in part from two different patents and combined in a manner not shown or suggested in either of them. In fact, what they represent is an attack on the patent based on finding elements in a plurality of places in the prior art and combining them through the use of hindsight and in the light of the disclosure of the patent in suit. The use of such hindsight has long been held to be improper. See *Goodyear Tire & Rubber Co. v. Ray-O-Vac Co.*, 321 U.S. 275, 279, 88 L. Ed. 721, 724 and the cases cited therein. This decision was cited by this Court in *National Sponge Cushion Co. v. Rubber Corp. of Cal.*, 286 F. 2d 731, 735.

> "It is of no significance that 'viewed after the event, the means * * * adopted seem simple and such as should have been obvious to those who worked in the field, but this is not enough to negative invention.' *Goodyear Tire & Rubber Co. v.*

> *Ray-O-Vac Co.*, 321 U. S. 275 279, 64 S. Ct. 593, 594, 88 L. Ed. 721. 'Now that it has succeeded, it may seem very plain to anyone that he could have done it as well. This is often the case with inventions of the greatest merit.' "

It is well settled that in the absence of something which suggests the desirability of combining elements from different prior patents, the mere fact that individual elements of a patented combination are separately old does not invalidate the patent. *The Troy Co. v. Products Research Co.*, 339 F. 2d 364, 366 (C.A. 9) 1964; *No-Joint Concrete Pipe Co. v. Hanson*, 344 F. 2d 13, 14 C.A. 9) 1965. As stated by Corpus Juris, the presumption of validity is not overcome by the fact that "an expert may be able to build up the patented process by selecting parts taken from the prior art". 69 CJS 599-600. Statements to the same effect have been made repeatedly by this Court. See *Pursche v. Atlas Scraper and Engineering Co.*, 300 F. 2d 467, 478 (C.A. 9) 1961; *Neff Instrument Corp. v. Cohu Electronics Inc.*, 298 F. 2d 82, 87 (C.A. 9); *Ry-Lock Co. Ltd. v. Sears Roebuck & Co.*, 227 F. 2d 615, 618 (C.A. 9) 1955; *Coleman v. Holly Mfg. Co.*, 233 F. 2d 71, 78 (C.A. 9) 1956; *Pointer v. Six Wheel Corp.*, 177 F. 2d 153, 160 (C.A. 9) 1949; *Payne Furnace & Supply Co. v. Williams-Wallace Co.*, 117 F. 2d 823, 826 (C.A. 9) 1941. As stated in the last cited case at page 826,

> "Prior patents 'cannot be reconstructed in the light of the invention in suit, and then used as part of the prior art.' "

In the present case although, as pointed out above, the need existed for many years and although bulkheads for freight cars were very old the Lincoln patent (PX 2-A) having been granted in 1880 and traveling beam cranes for use in freight cars having been shown in the patented

prior art at least since 1932 (see Lundborg PX 2-S), it remained for Wells to teach the combination of the patent in suit which has met with such widespread commercial success.

Also, with reference to the prior art, it should be noted Preco cited no analogous bulkhead art any more pertinent than that cited by the Patent Office. Thus, the bulkhead patents used in Preco's charts PX 31 and 32 are Wells No. 1,646,604 (PX 2-H) and Jones No. 1,803,760 (PX 2-I), both of which were cited by the Patent Office during the prosecution of the application for the patent in suit. (See DX A, column 6). And finally, the traveling beam crane prior art patents, even if considered with the bulkhead prior art patents do no more than show that the elements of the combination of the patent in suit are broadly old and this is no more than is shown by the art cited by the Patent Office. Thus, Dixon No. 2,227,807 (PX 2-N) shows a transverse member (which there is the upper frame member of the bulkhead) which is supported on rollers for movement along longitudinally extending tracks, Laffey No. 1,522,-784 (PX 2-E) shows a trolley movable along a transverse beam, and Wells No. 1,646,604 (PX 2-H) shows a bulkhead having a pivotal connection to a trolley.

The District Court clearly erred in holding (Finding 25, R. 394) that there is no evidence that some of the most pertinent prior art produced at the trial was not considered by the Patent Office during the prosecution of the patent in suit.

E. The Combination of the Patent in Suit Meets The Test of the A & P Case

In the present case the patent in suit discloses a new combination which produced a new result due to the co-action of its elements. In considering this requirement, a distinction must be drawn between the individual functions of the separate elements and the over-all function and result of the combination. In every combination of old elements the function of each element is always the function it has always performed. Thus, a gear always functions as a gear, a bearing always functions as a bearing, etc. This does not mean that new combinations of such elements are *ipso facto* unpatentable. *The Cold Metal Process Co. v. Republic Steel Corp.,* 233 F. 2d 828, 838-9 (C.A. 6, 1956). They are still patentable if the combination as a whole produces a new result due to co-action of the elements. *Troy Co. v. Products Research Co.,* 339 F. 2d 364, 366 (C.A. 9, 1964); *Kaakinen v. The Peelers Co.,* 301 F. 2d 170, 172, 173 (C.A. 9, 1962).

The combination of the patent in suit does produce a novel and useful result due to the mounting of the pivotal suspension, which permits the bulkhead to pivot about a vertical axis, on a carriage or trolley member which can slide along the length of a transverse bar which in turn is mounted for movement along the length of the car. This combination which is new, even though similar individual elements may be old, provides what may be called a universally adjustable vertical axis suspension. By this is meant the bulkhead is suspended for pivotal movement about a vertical axis which may be moved both transversely and longitudinally of the car. As a result, the bulkhead may be moved to any transverse restraining position at any

point along the length of the car and also may be positioned flat against either side wall at any point along the length of the car. *This universal adjustablility is the result of a co-action between the longitudinally movable transverse bar, the transversely movable carriage or trolley member and the pivotal connection between the bulkhead and the trolley member, and this is not found in any prior art construction.*

The District Court here, in support of its decision of invalidity under the doctrine of obviouness (TR. 1384) has adopted several findings and conclusions based on the language of the Supreme Court in the *A & P* case, 340 U.S. 147, 95 L. Ed. 162. See Findings of Fact Nos. 15, 16, 18, 21, 22 and 23, and Conclusions of Law Nos. 6, 7, 9, 10, 11 and 12. These are all conclusions arrived at on the basis of undisputed facts as to the construction and operation of the prior art and the construction and operation disclosed in the patent in suit and this Court is free to and in fact, it is the duty of this Court to determine *de novo* whether, in the light of these undisputed facts, the patent in suit is valid. Insofar as any of these determinations are considered to be properly findings of fact, it is respectfully submitted that they are clearly erroneous.

The *A & P* case, *supra,* and the *indicia* of invention there discussed were recently considered by this Court in *Twentier's Research Inc. v. Hollister Incorporated,* 319 F. 2d 898 (1963). In holding valid a patent relating to a patent identification means for which there had been a long-felt need and which met with commercial success, the Court in an opinion by Judge Jertberg stated, page 902,

> "It is not a difficult task to discern the foregoing indicia of inventiveness in the present patent. What is the 'something' which the combination of old elements in this patent contributes to the art, and ren-

ders the 'whole' more than 'the sum of its parts?' It *works*. None of the prior devices did.

"The long-felt need remained unsatisfied in spite of the attempts of the prior art. The peculiar combination of old elements necessary to actually accomplish the desired function had eluded both the artisan and the skilled mechanic for years. The Schneider patent hit upon that very combination with the result that it performed while the others merely promised. This result is sufficiently 'new', 'unusual' and 'surprising' to indicate inventiveness.

"The Schneider patent, therefore, filled a long-felt need which the prior art had been unable to satisfy effectively. Accordingly, the patented device was hailed as an advance by experts in the scientific field, and acceptance of the device in the market resulted."

The above language is generally applicable in the present case and although it should not be said here that none of the prior devices worked, none of them provided the universally adjustable vertical axis suspension which is responsible for the universal adoption of the Wells combination.

CONCLUSION

The District Court erred in holding Claims 1, 2 and 3 of the Wells patent in suit invalid on the ground of obviousness under Section 103 of Title 35 of the United States Code and on the ground that the claims define an unpatentable aggregation rather than a patentable combination and that they do not meet the standard of patentable invention required by law. It also erred in holding that the accused devices do not infringe. The undisputed facts and the applicable law require a determination that the Wells patent in suit is valid and that Claims 1, 2 and 3 have been infringed by Preco. The judgment should be reversed.

Respectfully submitted,

HARNESS, DICKEY & PIERCE,
By JOHN A. BLAIR,
ROBERT L. BOYNTON,

LYON & LYON,

By ROLAND N. SMOOT.

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

ROBERT L. BOYNTON,
Attorney.

PROOF OF SERVICE

Robert L. Boynton, counsel for Appellant, Evans Products Company, in the above entitled matter hereby certifies that three (3) copies of the foregoing Brief were placed in the United States mail, air mail, special delivery with postage fully prepaid addressed to Whann & McManigal, 315 West Ninth Street, Los Angeles, California 90015, on this 7th day of September 1966.

ROBERT L. BOYNTON.

APPENDIX A

DX AB—Chart re accused Model BC-3 .... 1a

DX AC—Chart re accused Model BC-4 .... 2a

DX AE-1—Chart re accused Model BD-2 .... 3a

DX AF—Chart re accused Model BD-2 .... 4a

DX AG, page 4—Page from brochure showing Evans' DF-B bulkhead equipment 5a

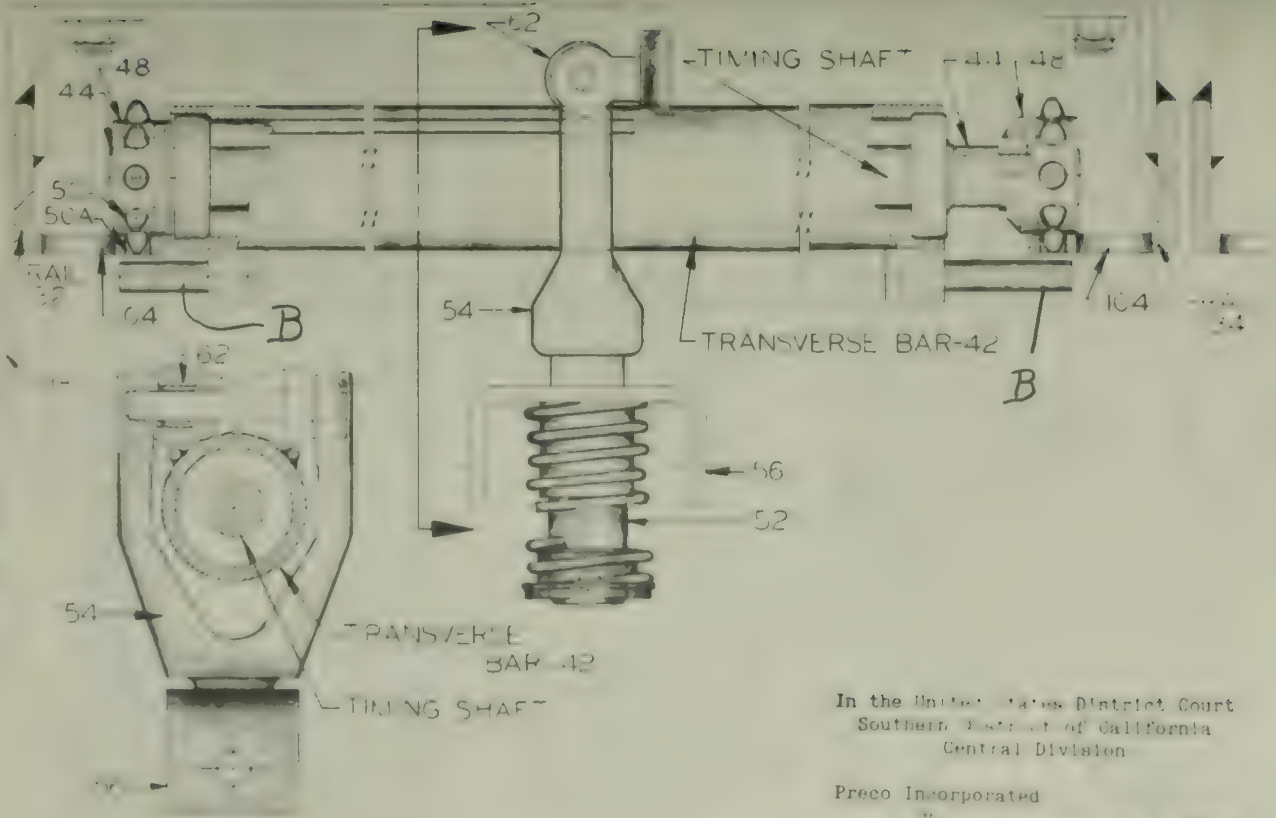
DX AN-2—Photograph showing accused Model BD-6 .... 6a

DX AO-2—Photograph showing Evans' DF-B bulkhead equipment 7a

DX AZ-1—Claim chart re Claim 1 of Wells patent in suit 8a

DX AZ-2—Claim chart re Claim 2 of Wells patent in suit 9a

DX AZ-3—Claim chart re Claim 3 of Wells patent in suit 10a

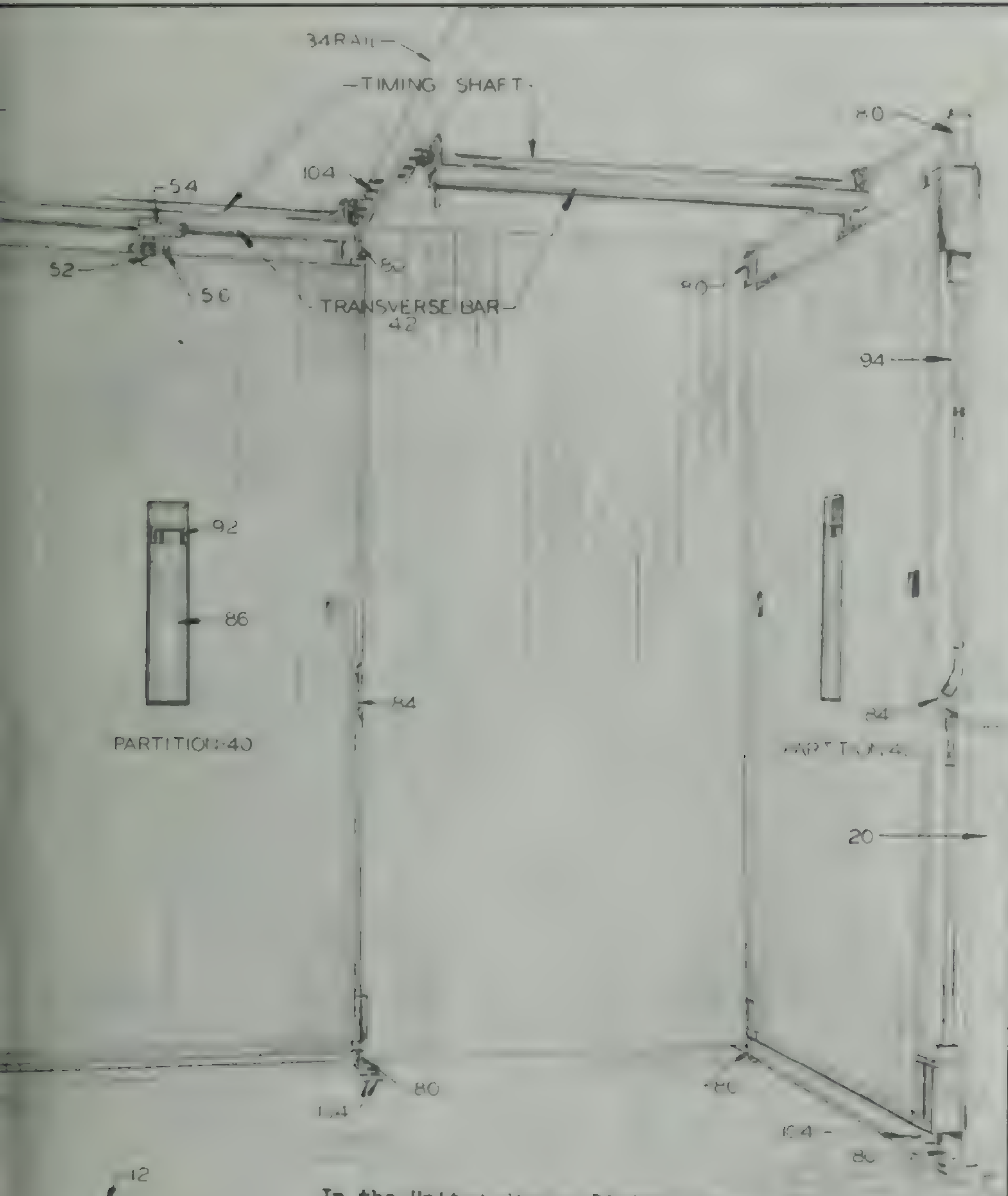


In the United States District Court
Southern District of California
Central Division

Preco Incorporated
v.
Evans Products Company
C. A. No. 63-453-IH

Defendant's Exhibit AB

Model BC-4

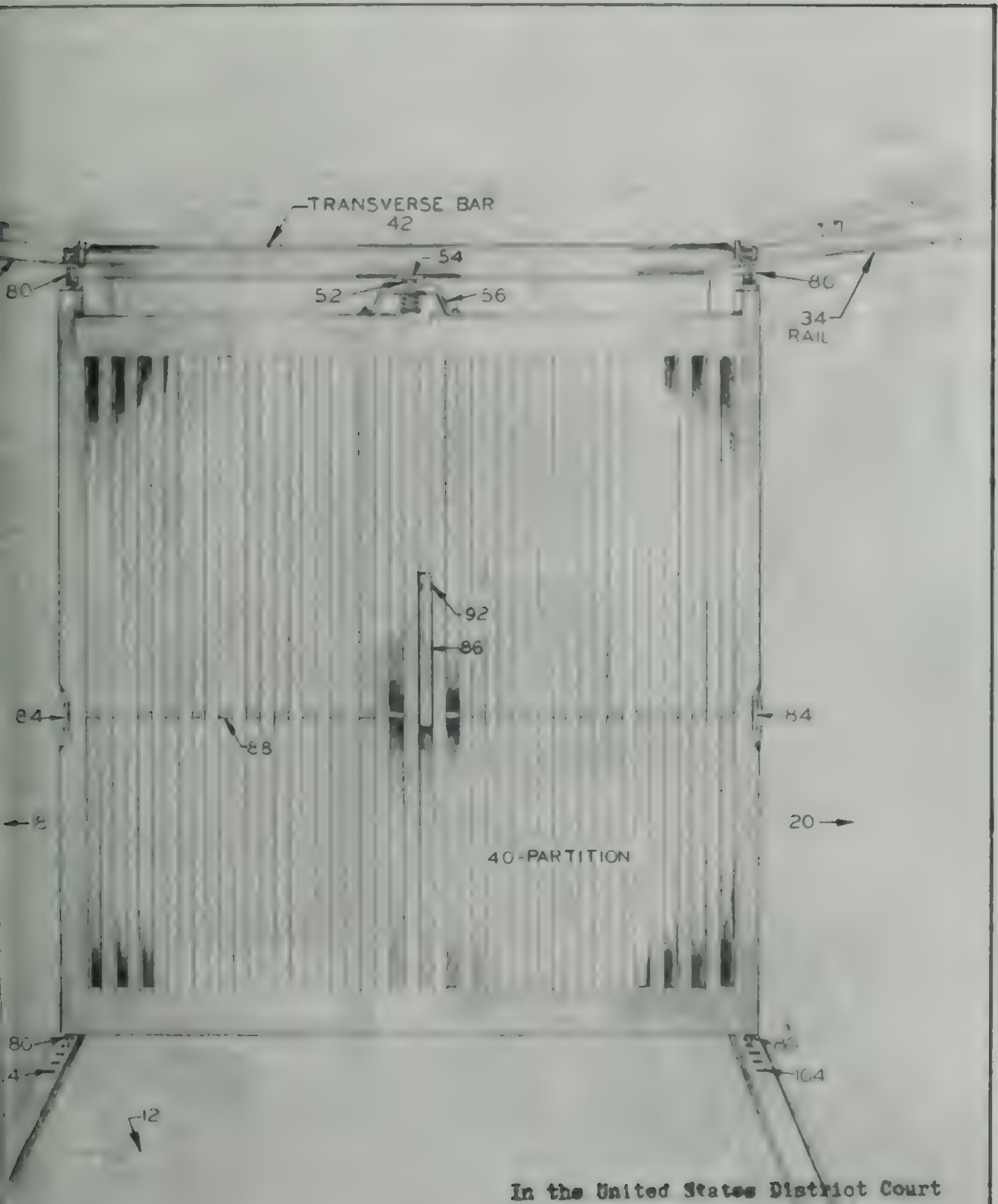


In the United States District Court
Southern District of California
Central Division

Preco Incorporated
v.
Evans Products Company
C. A. No. 63-453-IH

Defendant's Exhibit AC

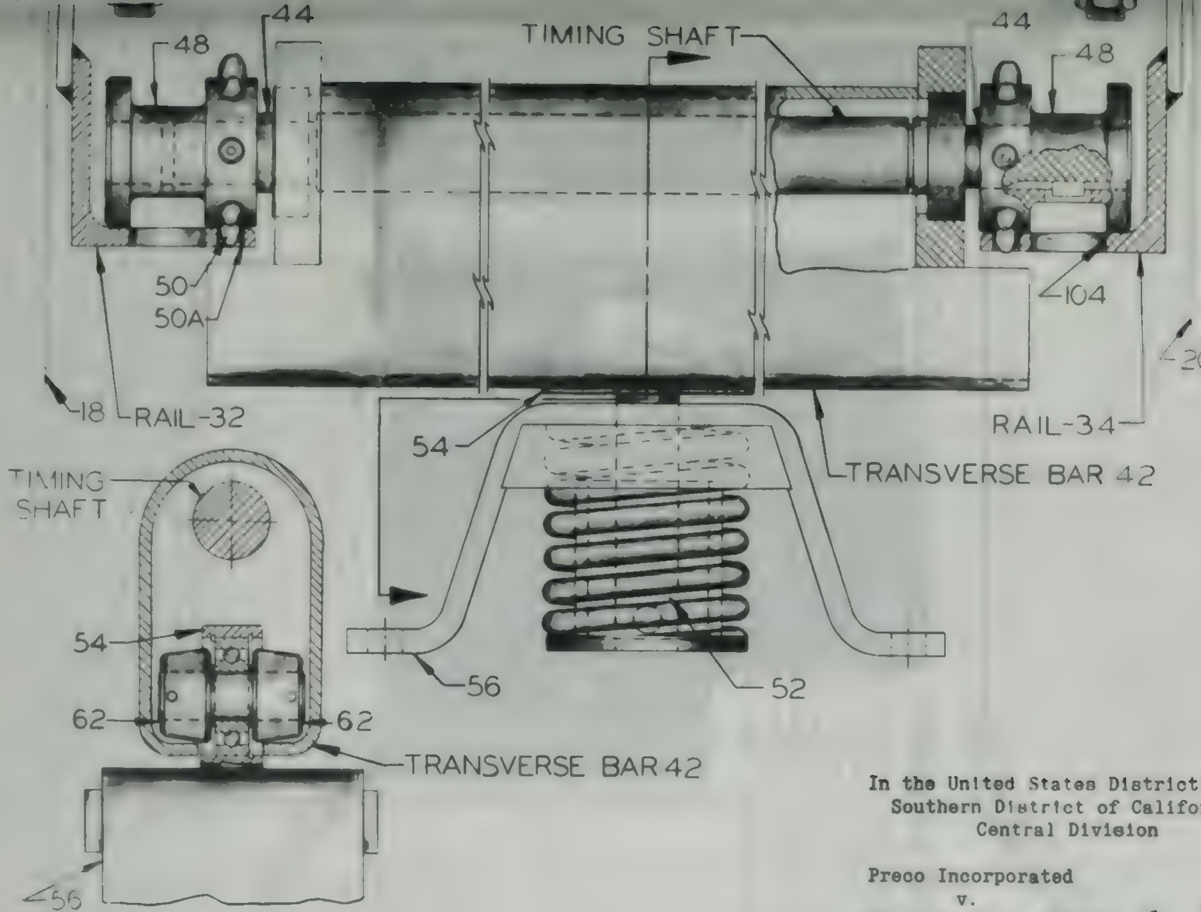
Model BD-2



In the United States District Court
Southern District of California
Central Division

Preco Incorporated
v.
Evans Products Company
C. A. No. 63-453-IH

Defendant's Exhibit AE-1



In the United States District Court
Southern District of California
Central Division

Preco Incorporated
v.
Evans Products Company
C. A. No. 63-453-IH

Defendant's Exhibit AF

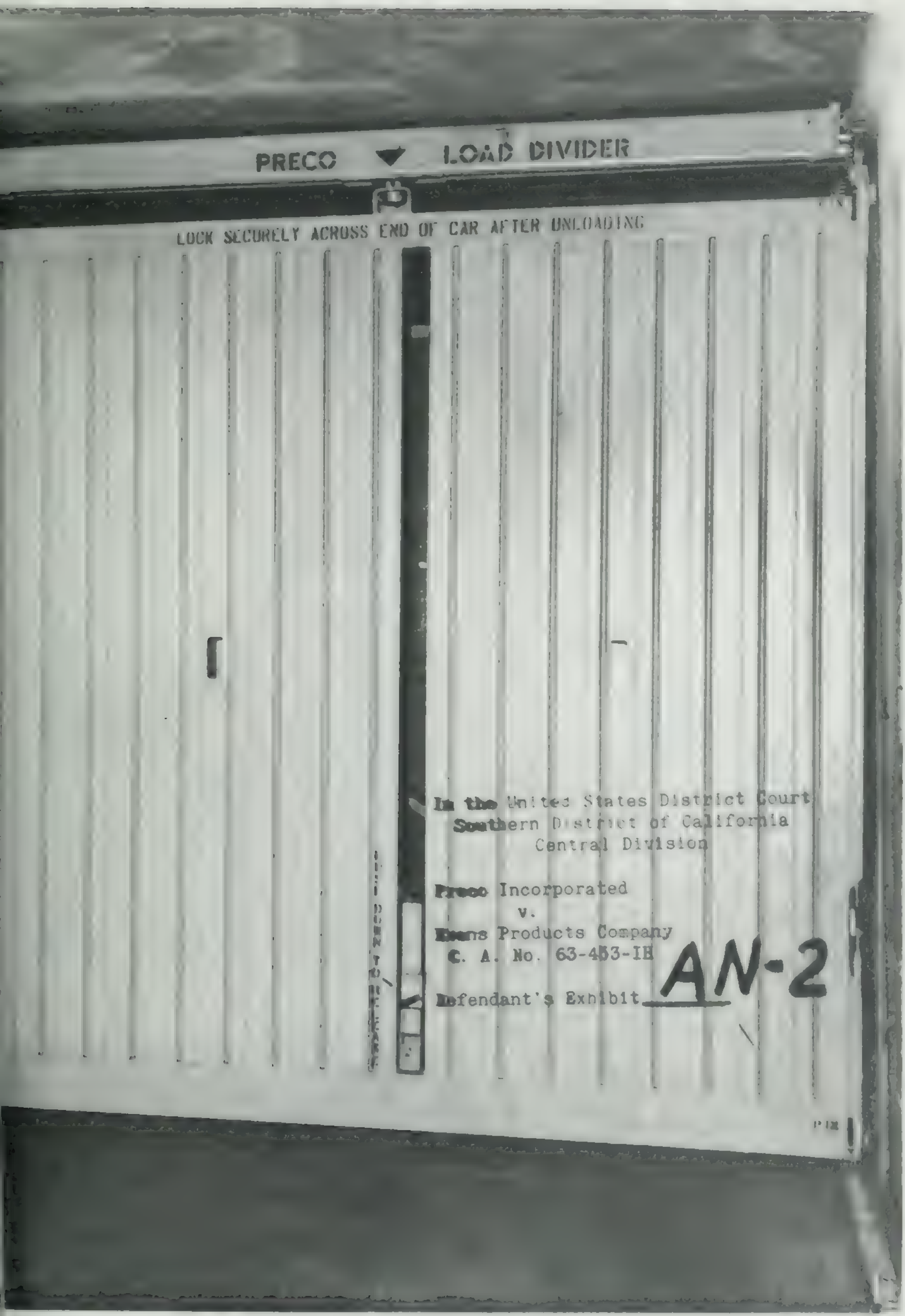
B... POSITION!

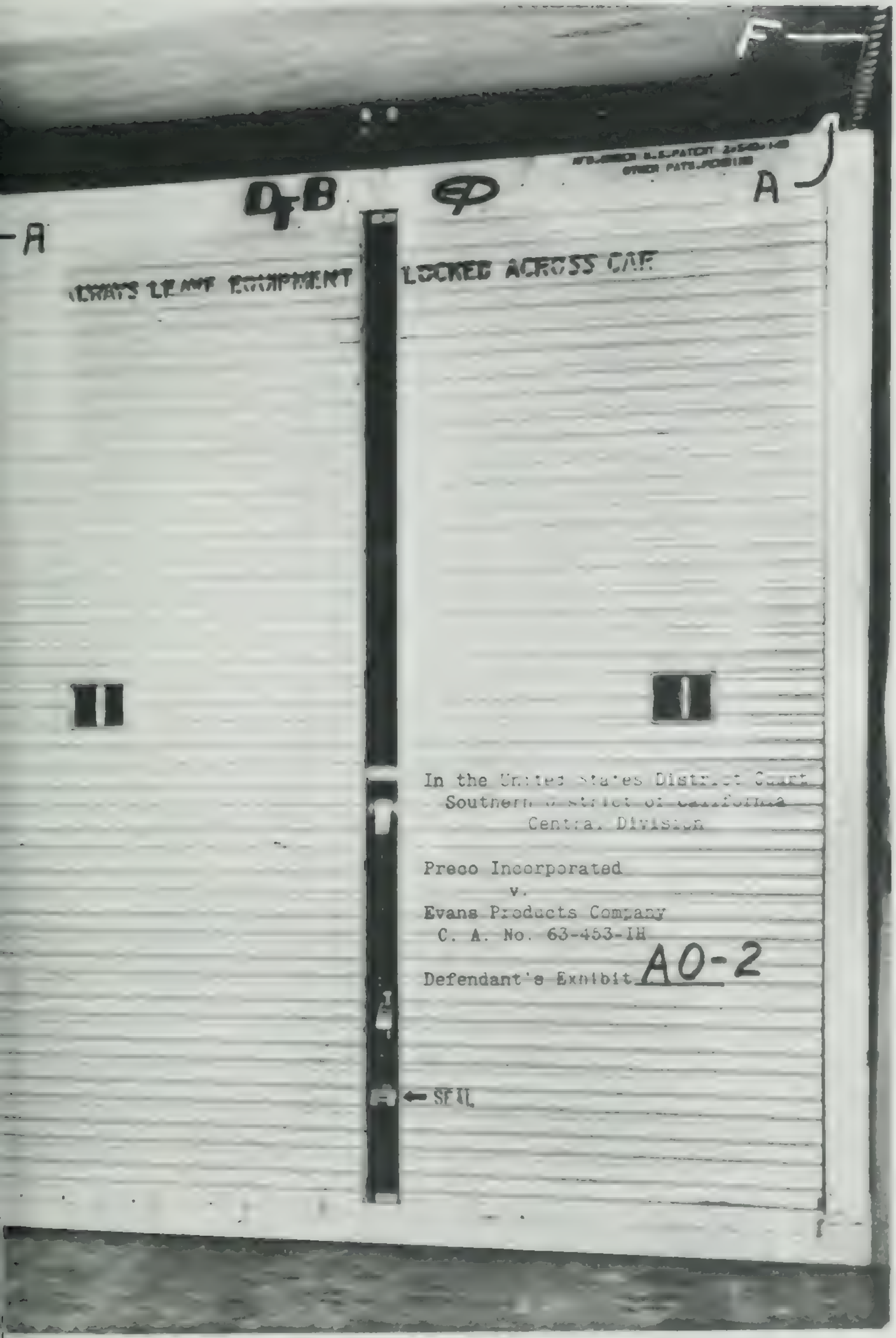
POSITIONING BULKHEADS

Move the bulkheads anywhere you wish with minimum effort. They may be pivoted and laid against the car walls . . . or they may be moved to partition the lading at intervals along the car's entire length, including doorway area.

across the car. **A SINGLE LEVER LOCATED** in the center of the DF B bulkhead does the locking and unlock
serves as a handle for positioning the bulkhead. This lever can be lifted from either side of the bulk
ifting the lever retracts four locking pins (a pin at each corner of the bulkhead), and the bulkhead
to move. Releasing the lever engages the pins in locking tracks which run the car's length at either
floor and ceiling. Positive locking is assured because the lever will not seat unless all four pins are
y engaged. **NO REMOVABLE PARTS.** DF B equipment is installed as part of the freight car structure. It
ontained. There are no parts in a DF-B equipped car to lose or to be replaced. **IDEAL FOR MECHANICAL
RATED AND INSULATED "RB" TYPE CARS.** Mechanical refrigerator cars equipped with Evans DF B bulk
re assured of better air flow which means faster cool down. No air flow interfering, truss type car
e required, as there are no center ceiling or floor tracks in the installation. DF B bulkheads installed

DX AG p. 4


PRECO LOAD DIVIDER
LOCK SECURELY ACROSS END OF CAR AFTER UNLOADING
In the United States District Court
Southern District of California
Central Division
Preco Incorporated
v.
Products Company
C. A. No. 63-453-IH
Defendant's Exhibit AN-2


F
A
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LOCKED ACROSS CAR
Preco Incorporated
v.
Evans Products Company
C. A. No. 63-453-IH
Defendant's Exhibit AO-2
SEAL

CHART APPLYING LANGUAGE OF CLAIM 1 OF WELLS PATENT 2,543,143 TO PATENT DISCLOSURE AND TO ACCUSED STRUCTURES

DX AZ-1

CLAIM 1 LANGUAGE	WELLS ET AL. PATENT 2,543,143	ACCUSED MODEL BD-2 Def's. Exs. S, T, AE-1, AE-2 and AF	ACCUSED MODEL BC-4 Def's. Exs. N, O, AC and AD	ACCUSED MODEL BC-3 Def's. Exs. J, AA and AB	ACCUSED MODEL BE-2 Def's. Exs. D, E, F, Y and Z
In combination with the body of a vehicle	The truck body	The railroad boxcar	Same as BD-2	Same as BD-2	Same as BD-2
having oppositely disposed walls	The opposite side walls 18 and 20 of the truck body.	The opposite side walls 18 and 20 of the boxcar	"	"	"
of means for subdividing said body into areas of preselected size, said means comprising	This is the complete partitioning means operative for the purpose stated. It includes the features set forth thereafter in the claim.	This is the complete partitioning means operative for the purpose stated. It includes the features set forth thereafter in the claim.	"	"	"
a row of detents carried by at least one of said walls	This is the row of openings 104 in one of the bars 100 or 102 into which the latch bolts 80 may project. The bars 100 and 102 are separate members positioned between the spaced side wall slats 26 and carried by the vertical side frame members 22.	NO The openings 104 in one of the rails 32 or 34 into which the latch bolts 80 may project. As pointed out below, the rail is carried by the walls and therefore the detents are so carried. In addition, the provision of detents in the floor is the full equivalent of detents carried by the walls.	NO "	" NO	" NO
oppositely disposed rails carried by said walls	The rails 32 and 34 are mounted on the top of the side walls 18 and 20. The truck body has no ceiling or roof structure.	NO The rails 32 and 34 are secured to the ceiling structure and that structure is "carried by" the side walls. Accordingly, the rails are carried by those walls. In addition, the rail mounting of the accused structure is the full equivalent of that specified.	NO Since this is a half width partition, two pairs of rails are employed. Each pair includes one rail at the side of the car and one midway between the sides. All rails are secured to the ceiling structure and therefore all are carried by the side walls.	Same as BC-4 NO	Same as BC-4 NO
above said detents	Since the rails are located on top of the side walls they are above the detents in bars 100 and 102.	NO The detents are openings 104 formed in the lower portion of the rail and therefore the major portion of the rail is "above said detents." Moreover, the rail surface on which the bar rests is wholly "above" the detents.	NO Same as BD-2	Same as BD-2 NO	Same as BD-2 NO
a bar disposed between and supported by said rails, the ends of said bar being slidably mounted on said rails for movement to selected positions with respect to the longitudinal length of said rails	The transverse bar is the bar 42 which is supported at its ends on the rails 32 and 34 by rollers 48. These rollers permit the bar to be moved along the length of the rails to any selected position while the bar is supported by the rails. This is what is meant by the language "slidably mounted."	NO The transverse bar is the bar 42 which is supported at its ends on the rails 32 and 34 by rollers 48. These rollers permit the bar to be moved along the length of the rails to any selected position while the bar is supported by the rails.	Same as BD-2 except that the bar 42 is shorter because of the shorter span of the rails required for a half width bulkhead or partition.	Same as BC-4 NO	Same as BC-4 except that the rollers which roll on the rails are fixed to the bar with the result that the entire bar rotates with the rollers. NO
said rails being constructed for guiding such movement	All guiding functions are performed by the coaction between the rails and the bar and the rails are constructed to perform that function.	NO All guiding functions are performed by the coaction between the rails and the bar and the rails are constructed to perform that function.	NO Same as BD-2	Same as BD-2 NO	Same as BD-2 NO
a partition member	The partition 40	The bulkhead or load divider 40.	Same as BD-2 except half width	Same as BC-4	Same as BC-4
a pivotal connection between said member and said bar for suspending one from the other and for permitting said member to turn into positions transverse and parallel with respect to said walls at desired times	This is the pivotal connection between the partition supporting bolt 66 and the socket housing 56.	NO This is the pivotal connection between the partition supporting yoke 56 and the pin 52, shown best in Def's. Ex. AF.	Same as BD-2	Same as BD-2 NO	Same as BD-2
means slidably mounting the said pivotal connection on the bar for longitudinal travel of said connection and partition member on the bar.	This is the roller bracket 54 which is supported by roller 62 which moves along the length of bar 42 while supported thereon.	NO This is the roller bracket 54 with its supporting rollers 62 which move along the length of the bar 42 while supported thereon.	"	" NO	" NO
and means cooperative with said detents carried by said partition member for maintaining said partition member in a position transverse with respect to said walls.	This is the locking means 80 which locks the partition in transverse position.	NO The latch bolt 80 which is "cooperative with said detents" 104 carried by one of the side walls. It also includes additional latch bolts which are cooperative with detents in the floor.	NO "	" NO	" NO

CHART APPLYING LANGUAGE OF CLAIM 2 OF WELLS PATENT 2,543,143 TO PATENT DISCLOSURE AND TO ACCUSED STRUCTURES

CLAIM 2 LANGUAGE	WELLS ET AL. PATENT 2,543,143	ACCUSED MODEL BD-2	ACCUSED MODEL BC-4 Def's. Exs. N, O, AC and AD	ACCUSED MODEL BC-3 Def's. Exs. J, AA and AB
In a vehicle body partition, the combination which comprises a platform	The floor of the truck body	Floor of car	Same as BD-2	Same as BD-2
side walls extended upwardly from the side edges of the platform,	The side walls 18 and 20 of the truck body.	The side walls 18 and 20 of the car	"	"
tracks, C-shape in cross section	The tracks 32 and 34 which are referred to in the patent specification as channel shaped in cross section and in claims 2 and 3 as C shape in cross section.	No The rails or tracks 32 and 34 are L shape in cross section which is a crude form of C-shape and is fully equivalent to a C-shape	No "	" No
carried by the upper parts of the side walls	The tracks 32 and 34 are mounted on top of the side walls 18 and 20. The truck body has no ceiling or roof structure.	No The tracks 32 and 34 are secured to the ceiling structure which is "carried by" the upper parts of the side walls. Accordingly, the tracks themselves are carried by those walls. In addition, the track mounting of the accused structures is the full equivalent of that specified.	No Since this is a half car width partition, two pairs of tracks are employed. Each pair includes one track at the side of the car and one midway between the sides. All of the tracks are secured to the ceiling structure and therefore all are carried by the upper parts of the side walls.	Same as BC-4 No
a transverse bar channel-shape in cross section extended between the tracks	The transverse bar 42. It is the same shape in cross section as the tracks 32 and 34. This is called a channel or a C-shape in the Wells patent.	No The transverse bar 42. It is channel shaped in cross-section in the same sense as is the bar 42 of the Wells patent.	Same as BD-2 except that the bar 42 is shorter because of the shorter span of the rails. Below the tracks, not between	No Same as BC-4 except that the accused bar is not channel shaped. The arrangement employed here is a mere reversal of parts and therefore an equivalent of the construction of the patent.
means movably mounting the ends of the transverse bar in the tracks,	The ends of the bar are supported for movement on rollers 48 which rest on the inside of the C shape tracks.	No The ends of the bar 42 are supported for movement on rollers 48 which rest on the inside of the L shape tracks.	No Same as BD-2	No Same as BD-2
a partition in the vehicle body and positioned below the said transverse bar	The partition 40.	The bulkhead or load divider 40.	Same as BD-2 except half width.	Same as BC-4
a bracket positioned between the said partition and transverse bar	The roller bracket 54.	No The roller bracket 54.	Same as BD-2	No Same as BD-2
means movably mounting the bracket in the bar	The bracket 54 is positioned within the channel shaped bar 42 and is movably mounted on roller 62.	No The bracket 54 is positioned within the channel shaped bar 42 and is movably mounted on rollers 62.	~~Same as BD-2~~	In this accused mechanism there is a reversal of parts in that the bar is in the supporting bracket 54 whereas in the patented construction the bracket is in the bar. The accused structure is the equivalent of that shown in the patent.
means pivotally suspending the partition from the bar whereby with the bracket positioned at one end of the bar the partition may be positioned against the inner surface of a side wall of the vehicle body,	The pivotal connection between the partition supporting bolt 66 and the socket housing 56 permits rotation of the partition about a vertical axis so that it can be positioned flat against a side wall.	No The pivotal connection between the partition support 56 and the stem 52 of the bracket 54 permits rotation of the partition about a vertical axis so that it can be positioned flat against a side wall.	"	No ~~Same as BD-2~~
and locking means on an edge of said partition positioned to engage a side wall of the vehicle body for retaining the partition in a position extended across the said vehicle body.	The locking means 80 at one edge engage openings 104 in the bars 100 and 102 which are fixed with respect to and carried by one of the side walls 18 or 20.	No The locking means 80 at the top edge of the partition engage the tracks 32 or 34 which are fixed with respect to and carried by the side wall 18 or 20.	No "	No "

In the United States District Court
Southern District of California
Central Division

Preco Incorporated
v.
Evans Products Company
C. A. No. 63-453-IH

Defendant's Exhibit AZ-2

10a

CHART APPLYING LANGUAGE OF CLAIM 3 OF WELLS PATENT 2,543,143 TO PATENT DISCLOSURE AND TO ACCUSED STRUCTURES

DX AZ-3

CLAIM 3 LANGUAGE	WELLS ET AL. PATENT 2,543,143	ACCUSED MODEL BD-2	ACCUSED MODEL BC-4 Def's. Exs. N, O, AC and AD	ACCUSED MODEL BC-3 Def's. Exs. J, AA and AB
(a) In a vehicle body partition, the combination which comprises a vehicle body including a platform	The truck body having a floor.	Car body having a floor.	Same as BD-2	Same as BD-2
(b) having upwardly extended side walls,	The side walls 18 and 20 of the car.	The side walls 18 and 20 of the car.	"	"
(c) tracks, C-shape in cross section	The tracks 32 and 34 which are referred to in the patent specification as channe shaped in cross section and in claims 2 and [illegible] as C-shape in cross section.	NO The rails or tracks 32 and 34 are L shape in cross section which is a crude form of C shape and is fully equivalent to a C shape	NO "	" NO
(d) carried by the upper parts of the side walls	The tracks 32 and 34 are mounted on top of the side walls 18 and 20. The truck body has no ceiling or roof structure.	NO The tracks 32 and 34 are secured to the ceiling structure which is "carried by" the upper parts of the side walls. Accordingly, the tracks are carried by those walls. In addition, the track mounting of the rails is fully equivalent to that specified.	NO Since this is a half car width partition, two pairs of tracks are employed. Each pair includes one track at the side of the car and one midway between the sides. All of the tracks are secured to the ceiling structure and therefore all are carried by the upper parts of the side walls.	Same as BC-4 NO
(e) a transverse bar, channel shape in cross section, extended between the tracks	The transverse bar 42 which extends transversely between tracks 32 and 34.	NO The transverse bar 42. It is channel shape in cross section in the same sense as is the bar 42 of the Wells patent.	NO? Same as BD-2 except that the bar 42 is shorter because of the shorter span of the rails.	NO Same as BC-4 except that the accused bar is not channel shaped. The arrangement employed here is a mere reversal of parts and therefore an equivalent of the construction of the patent.
(f) rollers journaled on the ends of the transverse bar and positioned in the tracks for movably mounting the bar in the tracks,	The ends of the bar 42 are supported for movement on rollers 48 which rest on the inside of the C section tracks.	NO The ends of the bar 42 are supported for movement on rollers 48 which rest on the inside of the L shape tracks.	NO Same as BD-2	Same as BD-2
(g) a partition in the vehicle body positioned below the transverse bar,	The partition 40 below bar 42.	Bulkhead or load divider 40 below bar 42.	Same as BD-2 except half width.	Same as BC-4 2 partitions, ½ width
(h) a bracket positioned between the partition and the bar	The roller bracket 54.	NO The roller bracket 54.	NO Same as BD-2	NO Same as BD-2
(i) rollers carried by the bracket and positioned in the bar movably mounting the bracket in the bar,	Roller 62 which movably mounts the bracket 54 in the bar 42.	Rollers 62 which movably mounts the bracket 54 in the bar 42.	"	NO The rollers 62 and the bracket 54 are positioned on the outside of the bar, which is a reversal of parts and the equivalent of the patented construction in which the rollers and bracket are inside the bar.
(j) a swivel joint pivotally suspending the partition from the bar whereby with the bracket located at one end of the bar the partition may be positioned against the inner surface of the adjacent side wall of the vehicle body,	The pivotal connection between the partition supporting bolt 66 and the socket housing 56 permits rotation of the partition about a vertical axis so that it can be positioned flat against a side wall.	NO The pivotal connection between the partition support 56 and the stem 52 of the bracket 54 permits rotation of the partition about a vertical axis so that it can be positioned flat against a side wall.	NO "	NO Same as BD-2
(k) spaced latch bolts slidably mounted in the edges of the said partition	Latch bolts 80 slidably mounted in the side edges of the partition.	NO Latch bolts 80 slidably mounted in the top edge of the partition, one at each side.	NO "	NO "
(l) rods having handles thereon pivotally mounted in the partition,	These are the levers 86 having handles 92. There are two such "rods." One rod operates latch bolts 80 at one side of the partition and the other operates bolts at the other side.	NO This is the lever 86 having a handle 92, the two levers or "rods" 86 of the patent being combined as one for operating latch bolts at both sides of the partition.	NO "	NO "
(m) means connecting the said latch bolts to the rods whereby the latch bolts may be withdrawn	Links 88 and levers 84 which connect each rod 86 to the associated latch bolts 80.	NO Rods 88 and levers 84 which connect the rod or lever 86 to the bolts 80.	NO "	NO "
(n) from locking engagement with the side walls of the vehicle body by the rods,	The latch bolts are withdrawn from engagement with the detent openings 104 in the bars 100 and 102 which are carried by and fixed with respect to the side walls 18 and 20.	NO The upper bolts are withdrawn from engagement with the detent openings 104 in the tracks 32 and 34 which are carried by and fixed with respect to the side walls 18 and 20.	NO "	NO "
(o) and means resiliently urging the said latch bolts into locking engagement with the side walls for retaining the partition in a transverse position in the vehicle body.	The springs 94 which act on the bolts through rods 86, links 88 and lever 84.	NO The springs 94 which act on the upper bolts.	NO "	NO "

APPENDIX B

Plaintiff's Exhibits	Description	For Identification	In Evidence
1	Certified File Wrapper and Contents of Wells et al Patent No. 2,543,143, patent in suit	25	153
2	Book of Prior Art Patents Relied on by Plaintiff	25	153
3	Model of structure of the patent in suit	25	799
4	Model of the Plaintiff's Structure Charged to Infringe	25	271
5	Preco Drawing No. B 17670 re Model BE-2	25	153
6	Preco Drawing No. B 17658 re Model BE-2	25	153
7	Preco Drawing No. B 17190 re Model BC-3	25	153
8	Preco Drawing No. B 17659 re Model BC-3	25	153
9	Preco Drawing No. B 17332 re Model BC-4	25	153
10	Preco Drawing No. B 17660 re Model BC-4	25	153
11	Preco Drawing No. B 17656 re Model BD-2	25	153
12	Preco Drawing No. B 17655 re Model BD-2	25	153
13	Photograph of Model BE-2	25	153

Plaintiff's Exhibits	Description	For Identification	In Evidence
14	Photograph of Model BE-2..	25	153
15	Photograph of Model BE-2..	25	153
16	Photograph of Model BC-3..	25	153
17	Photograph of Model BC-4..	25	153
18	Photograph of Model BC-4..	25	153
19	Photograph of Model BD-2..	25	153
20	Photograph of Model BD-2..	25	153
21	Drawing illustrating presence in prior art of the *first* element of Claim 1 of the patent in suit "In combination with the body of a vehicle having oppositely disposed walls, * * *"..........	25	1034
22	Drawing illustrating presence in prior art of the *second* element of Claim 1 of the patent in suit "of means for sub-dividing said body into areas of pre-selected size, said means comprising a row of detents carried by at least one of said walls,"..	25	1034
23	Drawing illustrating presence in prior art of the *third* element of Claim 1 of the patent in suit: "oppositely disposed rails carried by said walls above said detents,"	25	1034
24	Drawing illustrating presense in prior art of the *fourth*		

Plaintiff's Exhibits	Description	For Identification	In Evidence
	element of Claim 1 of the patent in suit: "a bar disposed between and supported by said rail,".............	25	1034
25	Drawing illustrating presence in prior art of the *fifth* element of Claim 1 of the patent in suit: "the ends of said bar being slidably mounted on said rails for movement to selected positions with respect to the longitudinal length of said rails,"........	25	1034
26	Drawing illustrating presence in prior art of the *sixth* element of Claim 1 of the pattent in suit: "said rails being being constructed for guiding such movement,".......	25	1034
27	Drawing illustrating presence in prior art of the *seventh* element of Claim 1 of the patent in suit: "a partition member,"	25	1034
28	Drawing illustrating presence in prior art of the *eighth* element of Claim 1 of the patent in suit: "a pivotal connection between said member and said bar for suspending one from the other and for permitting said member to turn into positions transverse and parallel with respect to said walls at desired times,"	25	1034

Plaintiff's Exhibits	Description	For Identification	In Evidence
29	Drawing illustrating presence in prior art of the *ninth* element of Claim 1 of the patent in suit: "means slidably mounting the said pivotal connection on the bar for longitudinal travel of said connection and partition member on the bar,".......	25	1034
30	Drawing illustrating presence in prior art of the *tenth* element of Claim 1 of the patent in suit: "and means cooperative with said detents carried by said partition member for maintaining said partition member in a position transverse with respect to said walls.".............	25	1034
31	Composite reproduction of of patent drawing of Staiger No. 2,437,486 (1948) and Wells No. 1,646,604 (1927)..	25	1112
32	Composite reproduction of patent drawings of Deady No. 1,622,574 (1927) and Jones No. 1,803,760 (1931)..	25	1113
33	Enlargement of Wells et al patent drawings, Patent No. 2,543,143	25	153
35	Plaintiff's First Set of Interrogatories dated October 25, 1963	25	153
36	Defendant's Answers to Plaintiff's Interrogatories dated December 5, 1963.....	25	153

Plaintiff's Exhibits	Description	For Identification	In Evidence
37	Plaintiff's Second Set of Interrogatories dated February 6, 1964	25	153
38	Defendant's Answers to Plaintiff's Second Set of Interrogatories dated February 21, 1964	25	153
39	Defendant's Answers to Plaintiff's Third Set of Interrogatories dated August 30, 1965	25	1238
39A	Defendant's Supplemental Answers to Plaintiff's Third Set of Interrogatories......	1237	1238
40	Composite Reproduction of patent drawings of Staiger No. 2,437,486 and Potter No. 226,102	25	1110
41	BC-3 Parts List—Drawing of Preco BC-3 Load Divider...	25	153
42-A, B, -C & D	Photographs of load divider made by Preco about 1941 embodying invention of Wieden Patent No. 2,360,029....	25	153
43-A, B, -C	Photographs of load divider made by Preco about 1941 embodying invention of Wieden Patent No. 2,360,029....	25	153
44-A	5-page Stress Test of Preco Load Divider 5FO812, dated May 26, 1941, Report I42....	25	219
44-B	5-page Report #RL1 Report of L2 Load Divider Installation by George E. Solnar....	25	219

Plaintiff's Exhibits	Description	For Identification	In Evidence
45-A, B, -C	Photographs of Preco Bunker made in 1946 embodying invention of Wieden Patent No. 2,474,563	25	153
46-A	Letter dated July 2, 1947 from Preco Incorporated to Acme Brokerage Co.	25	219
46-B	Letter dated July 26, 1947 from Acme Brokerage Company to Preco Incorporated	25	219
47	Page 41, January 1959—Railway Locomotives and Cars, Article entitled "Compartmentizer for Reefers"	25	153
48-A, B, -C, D	Photographs of Preco Load Divider, (Photographs Nos. 97-75-4, 97-75-3, 97-75-10, and 97-75-12) PFE July 1959	25	153
49-A	3-page Memo dated 2-6-58 from P. K. Beemer	25	219
49-B	Memorandum (4 pages) dated April 23, 1958, Subject—Load Dividers from P. K. Beemer	25	219
49-C	3-page Engineering Note 1958-4 "Load Divider—Preliminary Considerations"	25	219
49-D	3-page Memo dated July 2, 1958 entitled "Load Divider"	25	219
49-F	Letter dated May 29, 1959 Pacific Fruit Express Company to Preco Incorporated	25	219

Plaintiff's Exhibits	Description	For Identification	In Evidence
49-G	3-page Impact Test of PFE 301210 Equipped with Preco Load Divider, dated July 30, 1959, San Francisco, Calif...	25	219
49-H	Letter dated July 31, 1959 Pacific Fruit Express Company to Preco Incorporated	25	219
49-I	2-page letter dated July 21, 1959, with attached photographs to Mechanical Department of Santa Fe from Preco Incorporated	25	219
50-A	Magarian et al Patent No. 3,063,388, issued Nov. 13, 1962	25	153
50-B	Magarian et al Patent No. 3,208,403, issued September 28, 1965	25	153
51-A	Moorhead Patent No. 3,200,-773, issued August 17, 1965..	25	153
51-B	Miller Patent No. 3,203,363, issued August 31, 1965......	25	153
51-C	Erickson et al Patent No. 3,209,707 issued October 5, 1965	25	153
51-D	Moorhead et al application Serial No. 181,283, filed March 21, 1962 for Bulkhead	25	153
52	Loomis et al Patent No. 3,-017,843 issued January 23, 1963	25	153
54-A	Preco Drawing B 17385C dated November 13, 1962 (Preco Model BC-3)........	25	153

Plaintiff's Exhibits	Description	For Identification	In Evidence
54-B	Pacific Fruit Express Co. drawing 4R-5650 dated February 7, 1962 (Preco Model BC-3)	25	153
55-A	Preco Drawing B 17349C dated December 8, 1962 (Preco Model BC-4)........	25	153
55-B	Santa Fe Drawing SK-B-10427 dated April 2, 1962 (Preco Model BC-4)........	25	153
55-C	Santa Fe Drawing SK-D-10445, dated April 16, 1962 (Preco Model BC-4)........	25	153
56-A	Preco Drawing B 17916A dated January 10, 1964 (Preco Model BD-2)............	25	153
56-B	Pacific Car and Foundry Company Drawing dated January 28, 1964 (Preco Model BD-2)	25	153
57-A	QL Photograph 41209-10....	188	191
57-B	QL Photograph 41209-8.....	188	191
57-C	QL Photograph 41209-7.....	188	191
57-D	QL Photograph 41209-6.....	188	191
59	File Wrapper—Erickson et al Patent No. 3,209,707......	950	981
60	Erickson sketches	1297	1297

Defendant's Exhibits	Description	For Identification	In Evidence
A	Wells Patent No. 2,543,143	16	153
B	Preco Drawing B 17670 re Model BE-2	16	153
C	Preco Drawing B 17658 re Model BE-2	16	153
D	Preco Photograph re Model BE-2	16	153
E	Preco Photograph re Model BE-2	16	153
F	Preco Photograph re Model BE-2	16	153
H	Preco Drawing B 17190 re Model BC-3	16	153
I	Preco Drawing B 17659 re Model BC-3	16	153
J	Preco Photograph re Model BC-3	16	153
L	Preco Drawing B 17332 re Model BC-4	16	153
M	Preco Drawing B 17660 re Model BC-4	16	153
N	Preco Photograph re Model BC-4	16	153
O	Preco Photograph re Model BC-4	16	153
Q	Preco Drawing B 17656 re Model BD-2	16	153
R	Preco Drawing B 17655 re Model BD-2	16	153

Defendant's Exhibits	Description	For Identification	In Evidence
S	Preco Photograph re Model BD-2	16	153
T	Preco Photograph re Model BD-2	16	153
Y	Chart showing construction of Plaintiff's equipment illustrated in Exhibits A-1 to A-6 attached to Plaintiff's First Set of Interrogatories —re Model BE-2...........	16	153
Z	Chart showing construction of Plaintiff's equipment illustrated in Exhibits A1 to A6 attached to Plaintiff's First Set of Interrogatories —re Model BE-2...........	16	153
AA	Chart showing construction of Plaintiff's equipment illustrated in Exhibits B-1 to B-4 attached to Plaintiff's First Set of Interrogatories —re Model BC-3...........	16	153
AB	Second chart showing construction of Plaintiff's equipment illustrated in Exhibits B-1 to B-4 attached to Plaintiff's First Set of Interrogatories—re Model BC-3......	16	153
AC	Chart showing construction of Plaintiff's equipment illustrated in Exhibits C-1 to C-5 attached to Plaintiff's First Set of Interrogatories —re Model BC-4............	16	153

Defendant's Exhibits	Description	For Identification	In Evidence
AD	Second chart showing construction of Plaintiff's equipment illustrated in Exhibits C-1 to C-5 attached to Plaintiff's First Set of Interrogatories—re Model BC-4......	16	153
AE-1 AE-2	Charts Showing construction of Plaintiff's equipment illustrated in Exhibits D-1 to D-5 attached to Plaintiff's First Set of Interrogatories re Model BD-2.............	16	153
AF	Second chart showing construction of Plaintiff's equipment illustrated in Exhibits D-1 to D-5 attached to Plaintiff's First Set of Interrogatories—re Model BD-2......	16	153
AG	Literature illustrating Defend's commercial bulkhead equipment employing the invention of the patent in suit	16	157
AJ	Detailed DFB Ownership List as of June 30, 1965..........	16	162
AK	Unarco Settlement Agreement	16	897
AL	Judgment in Evans Products Company v. Unarco Industries, Inc., Civil Action 65 C-592	16	827
AM	Judgment in Unarco Industries, Inc. v. Evans Products Company, Civil Action 62 C-1659	16	900

Defendant's Exhibits	Description	For Identification	In Evidence
AN-1 to AN-6	Photographs of SP 697999—Load Divider Installation...	16	667
AO-1 to AO-3	Photographs of SP 692967—DFB Installation	16	668
AQ	Selected Answers of Plaintiff to Defendant's Interrogatories and Request for Admissions	16	153
AR	Stipulation re Defendant's Charts DX Y, Z, AA, AB, AC, AD, AE-1, AE-2 and AF	16	153
AS-1	PCF Drawing SK 1-28-64..	16	153
AS-2	Preco Drawing B-17916 A..	16	153
AS-3	Preco Drawing B-17385 C..	16	153
AS-4	PFE Drawing 4R-5650......	16	153
AS-5	Sketch dated Dec. 3, 1962..	16	153
AS-6	Santa Fe Drawing SK-B-10427	16	153
AS-7	Santa Fe Drawing SK-D-10445	16	153
AS-8	Preco Drawing B-17349C...	16	153
AT	Collection of prior patents covering bulkheads for railroad cars	16	673
AU-1	PCF Car Construction Drawing 6557-3	16	153
AU-2	PCF Car Construction Drawing R 197-45..............	16	153
AU-3	PCF Car Construction Drawing R 198-17..............	16	153

Defendant's Exhibits	Description	For Identification	In Evidence
AV	PCF Drawing 6557-9........	507	559
AW	Car Builders Cyclopedia....	673	673
AX	J.A.B. Sketch re Wells' structure	854	854
AY	Sketch of Preco bar end construction	902	903
AZ-1	Infringement Chart of Claim 1 of Wells et al Patent No. 2,543,143	1243	1244
AZ-2	Infringement Chart of Claim 2 of Wells et al Patent No. 2,543,143	1243	1244
AZ-3	Infringement Chart of Claim 3 of Wells et al Patent No. 2,543,143	1243	1244

No. 20,868

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Evans Products Company,

Appellant,

vs.

Preco Incorporated,

Appellee.

BRIEF FOR APPELLEE PRECO INCORPORATED.

R. Welton Whann,
Robert M. McManigal,
315 West Ninth Street,
Los Angeles, Calif. 90015,
Attorneys for Appellee.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

TOPICAL INDEX

	Page
Jurisdiction	1
Statement of the case	2
Question involved and the burden of proof	4
Summary of argument	6
Evans' specification of errors	8
Infringement and equivalency are questions of fact	9
The Wells patent in suit No. 2,543,143	15
The Structure of the Wells patent in suit has never been produced and is not suitable for use in a freight car	16
Evans made its first DF-B installation, which Evans contends was covered by the patent in suit, many months prior to any knowledge of the Wells patent in suit	19
Oral opinion of Trial Court on issue of validity	20
The Trial Court's Finding of Fact on invalidity	20
The load dividers of Preco	25
Trial Court's Opinion on Non-Infringement	28
Trial Court's Findings of Fact on Non-Infringement	30
Exhibits AZ-1, AZ-2 and AZ-3	31
The admissions against interest in the file wrapper of the Erickson, Moorhead, et al. Application, Exhibit 59, and the admissions of Evans' Witness Moorhead	34

Page

Moorhead testified that the Wells structure, Preco structures and Evans structures all present different mechanical means 35

Admission re locking pins carried by the bulkhead at the top and bottom thereof and rails having means cooperating with the locking pins 35

Admission that dual function of rails not taught in Wells patent 36

Admission that disclosure of Wells patent inconsistent with respect to moving bulkhead to a position parallel against side wall 37

Admission that Wells track bar 42 is an entirely different construction than a rotating squaring bar having sprockets on the opposite ends thereof 39

Admission that sprocket wheels mounted on transverse bar and held against rotation differed from Wells construction 39

Exhibit 59 is an admission against interest 40

The Findings of invalidity are correct and are supported by the evidence 41

The Findings of Fact on Non-Infringement are correct and are supported by the evidence 52

All of elements of any claim are not found in any accused device 52

Re: Findings of Fact 30, 32, 33, 35, 37 and 39 52

Differences in structure and mode of operation 56

Findings 28, 29 and 40 56

File wrapper estoppel 62

Finding 41 62

Conclusion 65

TABLE OF AUTHORITIES CITED

Cases Page

Air Devices, Inc. v. Air Factor (C.A. 9, 1954), 210 F. 2d 481 61

Altoona Theatres v. Tri-Ergon Corp., 294 U.S. 477 44

Bergman v. Aluminum Lock Shingle Corp. of America (C.A. 9, 1957), 251 F. 2d 801 ....42, 43, 52

Bliss v. Gotham Industries, Inc. (C.A. 9, 1963), 316 F. 2d 848 42

Calmar, Inc. v. Cook Chemical Company, 383 U.S. 1, 15 L. Ed. 2d 545 ....13, 48

Canadian Ingersoll-Rand Co. v. Peterson Products (C.A. 9, 1965), 350 F. 2d 18 ....4, 5, 14, 40

Cincinnati Milling Machine Co. v. Turchan (D.C., E.D., Mich., S.D., 1951), 101 F. Supp. 621 20

Colgate-Palmolive Company v. Cook Chemical Company, 383 U.S. 1, 15 L. Ed. 2d 545 ....13, 48

Continental Connector Corp. v. Houston Fearless Corp. (C.A. 9, 1965), 350 F. 2d 183 ....5, 6, 42, 43, 46, 50, 52

Del Francia v. Stanthony Corporation (C.A. 9, 1960), 278 F. 2d 743 (note 5) 9

Eagle, et al. v. P. & C. Hand Forged Tool Co. (C.A. 9, 1935), 74 F. 2d 918 ....6, 42

Engelhard Industries, Inc. v. Research Instrumental Corp. (C.A. 9, 1963), 324 F. 2d 347 58

Exhibit Supply Co. v. Ace Patents Corporation, 315 U.S. 126 64

Foster Metals Products v. Jacoby-Bender, Inc. (C.A. 1, 1958), 255 F. 2d 869 41

Page

Graham, et al. v. John Deere Company of Kansas City, et al. and associated cases, 383 U.S. 1, 15 L. Ed. 2d 545 ....6, 7, 13, 48, 50

Grant v. Koppl (C.A. 9), 99 F. 2d 106 ....7, 62

Graver Tank & Mfg. Co., Inc., et al. v. Linde Air Products Co., 339 U.S. 605, 94 L. Ed. 1097 ..10, 62

Great Atlantic & Pacific Tea Co. v. Supermarket Corp., 340 U.S. 147 ....7, 42, 43, 52

Hartford-Empire Co. v. Obear-Nester Glass Co. (C.A. 8, 1930), 39 F. 2d 769 19

Jaybee Mfg. Corp. v. Ajax Hardware Mfg. Corp. (C.A. 9, 1961), 287 F. 2d 228 51

Kromer v. Riegel Textile Corporation (C.A. 7, 1955), 227 F. 2d 741 20

Kwikset Locks v. Hillgren (C.A. 9, 1954), 210 F. 2d 483 ....42, 43, 52

Lincoln Engineering Co. v. Stewart-Warner Corp., 303 U.S. 545 ....6, 42

Lockwood v. Langendorf United Bakeries, Inc., 324 F. 2d 82 56

McRoskey v. Braun Mattress Co. (C.A. 9, 1939), 107 F. 2d 143 60

Moist Cold Refrigerator Co. v. Lou Johnson Co. (C.A. 9, 1957), 249 F. 2d 246 9

Monroe Auto Equipment Company v. Superior Industries, Inc. (C.A. 9, 1964), 332 F. 2d 473 ....50, 51

Moon v. Cabot Shops, Inc. (C.A. 9, 1959), 270 F. 2d 539 ....10, 65

Nelson v. Batson (C.A. 9, 1963), 322 F. 2d 132 55

Oregon Saw Chain Corporation v. McCulloch Motors Corporation (C.A. 9, 1963), 323 F. 2d 758 ..65

Page

Oriental Foods v. Chun King Sales (C.A. 9, 1957), 244 F. 2d 909 42

Pressteel Company v. Halo Lighting Products, Inc. (C.A. 9, 1963), 314 F. 2d 695 .... 42, 51

S. S. Kresge Co. v. Davies (C.A. 8, 1940), 112 F. 2d 708 20

Schmeiser v. Thomasian (C.A. 9, 1955), 227 F. 2d 875 42

Stilz v. United States, 269 U.S. 144 9

The Union Paper Bag Case, 97 U.S. 121 62

United States v. Adams, 15 L. Ed. 2d 572, 148 U.S.P.Q. 479 50

Rules

Federal Rules of Civil Procedure, Rule 73(a) 2

Statutes

United States Code, Title 28, Sec. 1291 2

United States Code, Title 28, Sec. 1338(a) 2

United States Code, Title 28, Sec. 2201 2

United States Code, Title 35, Sec. 103 ..6, 13, 14, 49

Textbooks

69 Corpus Juris Secundum, Sec. 292, p. 861 62

3 Walker on Patents, (Deller's Ed.), Sec. 496, p. 1750 62

No. 20,868

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

EVANS PRODUCTS COMPANY,

Appellant,

vs.

PRECO INCORPORATED,

Appellee.

APPELLEE'S BRIEF.

Jurisdiction.

Appellant Evans Products Company (defendant and counter-claimant in the Trial Court), owner of the patent in suit, appealed from a Final Judgment of invalidity and non-infringement entered January 11, 1966 [R. 404],[1] which is supported by Findings of Fact and Conclusions of Law [R. 386], both of which are based on the Trial Court's oral Opinion of November 19, 1965 [Tr. 1382].

The Trial Court found the Wells, *et al.* patent in suit No. 2,543,143, Exhibit A,[2] and each of its three

[1]The Transcript of Record filed with the Clerk on this Appeal is in three volumes. The Clerk's Record bears page markings 1 through 415. Reference to this Record appear as R. followed by the appropriate page number as [R. 1]. The fourteen volumes of Reporter's Transcript will appear herein as TR followed by the appropriate page number as [Tr. 1].

[2]The patent in suit is Wells, *et al.* No. 2,543,143 and will be referred to herein either as the Wells patent or as the patent in suit.

claims, invalid and also non-infringed by Appellee Preco Incorporated's[3] (plaintiffs-counterdefendant in the Trial Court) accused load dividers.

This action was brought for Declaratory Judgment in a controversy arising under the Patent Laws of the United States. Evans counterclaimed for patent infringement. Jurisdiction of the District Court is founded on Sections 1338(a) and 2201 of Title 28 United States Code. The pleadings showing the existence of the jurisdiction are the Complaint for Declaratory Relief in Connection with United States Letters Patent No. 2,543,143 [R. 2], Defendant's Answer to Complaint and Defendant's Counterclaim [R. 7], Plaintiff's Reply to Counterclaimant's Counterclaim [R. 12], and Defendant's Answer, and Amended and Supplemental Counterclaim [R. 23].

Defendant's Notice of Appeal [R. 406] was filed February 9, 1966, within the time specified by Rule 73(a) of the Federal Rules of Civil Procedure. This Court has jurisdiction under Section 1291 of Title 28 United States Code.

Statement of the Case.

The Trial in this cause lasted twelve days, each party presenting testimonial evidence and exhibits on its behalf. The Trial Court visited a freight yard on November 2, 1965, and saw actual full-sized load dividers mounted in freight cars. These load dividers, Evans' Model DF-B and Preco's Models BD-6 and BC-3 were operated and demonstrated for the Trial Court [Tr. 103-151]. Fact and expert witnesses for both parties

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[3]Throughout the Brief Appellant will be referred to as "Evans" and Appellee will be referred to as "Preco".

testified fully. Many prior art patents, drawings, photographs and other exhibits were introduced into evidence. Exhibit 3, a model of the structure of the patent in suit and Exhibit 4, a model of Preco's Model BD-2 Load Divider were extensively used at the trial. The Trial Court resolved the conflicts in evidence and resolved them favorably to Preco. At the conclusion of oral arguments the Trial Court rendered its oral Opinion from the Bench [Tr. 1382].

Following its Opinion the Trial Court required both parties to submit proposed findings of fact and conclusions of law; and the Court considered both. A hearing was had to discuss the proposed findings of fact and conclusions of law on December 27, 1965, and after a full discussion, Preco's proposed findings of fact and conclusions of law were accepted with minor changes and Evans' proposed findings of fact and conclusions of law were rejected. The Findings of Fact and Conclusions of Law of the Trial Court appear in the Record at 386 through 399. At the conclusion of the discussion of the Findings of Fact and Conclusions of Law the Trial Court stated to Evans' counsel:

> "* * * And if they are all right when I get them back, I will go ahead and sign them, unless defendant particularly wants a chance to object again.
>
> "MR. SMOOT: No, your Honor, we would have no objection." [Tr. Dec. 27, 1965, p. 48].

Evans' Brief, on page 4 states: "On the issue of infringement, there is no issue of fact. * * *", and on page 5, states: "On the issue of validity the evidence adduced does not present any disputed fact question. * * *". If this is true then Evans must now accept the Trial Court's Findings of Fact; and Evans must not

assert that the Trial Court was manifestly wrong or clearly erroneous in any of its Findings of Fact. Yet, in Evans' Brief, page 3, it is charged that the Court disregarded undisputed evidence and made "* * * the further irrelevant holding that the construction shown in the Wells patent had not been commercialized. (Finding No. 27, R. 394.)".

Evans has made, throughout its Brief, certain other allegations of error in Findings of Fact, but has not, it is submitted, carried its burden of establishing that the Findings of Fact are not supported by the evidence. Evans would like to have this Court believe that all questions before the Court are questions of law, and, therefore, freely re-assessable and decidable by this Court, irrespective of the Findings of Fact of the Trial Court. This, however, is not the case as we will show in this Brief.

Question Involved and the Burden of Proof.

The basic question in this appeal is whether the Findings of Fact with respect to invalidity and non-infringement are supported by substantial evidence.

Evans has not attempted to show and has not shown that there is no substantial evidence to support the Trial Court's Findings of Fact with respect to either invalidity or non-infringement, and, therefore, Evans has not sustained its burden. As stated in *Canadian Ingersoll-Rand Co. v. Peterson Products* (C.A. 9, 1965), 350 F. 2d 18, 21, 22:

> "* * * In order to obtain a reversal, appellants must convince us that the trial court erred as to each and every ground relied upon by that court in holding the patents invalid and, in addition, that the trial court erred in holding that the patents have not been infringed."

See also *Continental Connector Corp. v. Houston Fearless Corp.* (C.A. 9, 1965), 350 F. 2d 183, 186.

This Court in *Canadian Ingersoll-Rand Co. v. Peterson Products, supra,* at pages 25 and 26 held:

> "Appellants argue that findings of fact relating to the question of obviousness are clearly erroneous in that they are not supported by substantial evidence.
>
> "In support of these findings there was some opinion testimony, primarily that of Dirks Foster, a patent attorney. Appellants think his testimony should not have been accorded much weight, but this was for the trial court to determine. The main support for these findings, however, comes from all of the evidence, testimony and exhibits bearing upon the state of the art prior to Anderson, and what he contributed to that art. As to some of the facts, the evidence is in conflict. But most of the evidence that is in conflict is susceptible of varying interpretations and evaluations and gives rise to a choice of inferences, all of which could reasonably appeal differently to one fact finder than to another.
>
> "Absent some plain signal that the trial court has gone far amiss, this court rarely finds reason for overturning findings so dependent upon such a process of appraisal. We perceive no such signal here. * * *
>
> * * * * *
>
> "It is therefore our view that the findings of fact relevant to the section 103 question are not clearly erroneous. We are also of the opinion that, given these facts, the trial court correctly applied the statutory proscription against the patenting of that which is obvious, as stated in that section."

The "Statement of the Case" in Evans' Brief (pp. 2-19) is controverted. It is replete with erroneous statements, even in Section "E", p. 10 *et seq.* in which the footnote states: "The facts set forth in this section are undisputed, except * * *".

Summary of Argument.

In this Brief we will argue the more salient grounds of invalidity and non-infringement.

The three claims of the patent in suit are invalid because each of their elements, the functions of each element, and the coaction of each element are old and well known in the art. No invention is involved in bringing together these elements (*Eagle, et al. v. P. & C. Hand Forged Tool Co.* (C.A. 9, 1935), 74 F. 2d 918).

Wells used elements and functions and coactions which comprise a part of the existing fund of public knowledge and produced results which would be expected by one skilled in the art, and provided an assembly of elements which does not provide any unusual or unexpected results.

What Wells did was obvious as a whole to a person having ordinary skill in the load divider art; and the claims are invalid under 35 U.S.C. §103. (See *Graham, et al. v. John Deere Company of Kansas City, et al. and associated cases,* 383 U.S. 1, 15 L.Ed. 2d 545, and *Continental Connector Corp. v. Houston Fearless Corp.* (C.A. 9, 1965), 350 F. 2d 183).

The elements defined by the claims are an aggregation of old elements and are unpatentable under *Lincoln Engineering Co. v. Stewart-Warner Corp.,* 303 U.S. 545, and numerous Ninth Circuit cases cited in this Brief.

The claims are furthermore invalid because Wells did not meet the standard of invention as required by the Supreme Court in the *Great Atlantic & Pacific Tea Co. v. Supermarket* 340 U.S. 147, and the *Graham, et al. v. John Deere, et al.* case *supra.*

Evans admitted that the structure shown in the Wells patent in suit was never manufactured, used or sold, and that its design was unsuited for railroad use.

Preco will point out in detail the admissions against interest made by Evans in its prosecution of the Erickson, Moorhead, *et al.* application, Exhibit 59, owned by Evans. In the Patent Office proceedings Evans emphasized the substantial and important differences between its load divider and the Wells device, and virtually admitted invalidity and non-infringement. Evans' witness Moorhead, its Director of Engineering and Patents, also made significant admissions against interest which are fatal to Evans' position.

There are real differences between the patented device and the Preco load dividers. In fact, the Preco "load dividers are so different from the Wells device that it is like comparing apples and oranges".

The claims do not read on the Preco accused structures because many elements of each of the three claims are absent. Preco uses different elements, a different combination of elements, and the coaction between the elements are different.

Preco's load dividers have a different mode of operation and, therefore, there can be no infringement irrespective of the language of the claims (*Grant v. Koppl* (C.A. 9), 99 F. 2d 106).

Three of the important differences which establish non-infringement are:

(a) the incorporation in the accused devices of a rotating squaring bar having sprockets on the opposite ends thereof;

(b) rails having openings engageable by the sprockets and mounted on the ceiling rather than the wall structure and of different shape than the C-shaped rails of the patent in suit; and

(c) locking devices which operate in an entirely different manner, particularly, in that the detents in Preco's devices are in the rails rather than in the side walls, and in that the bottom bolts, when the load divider is in locked position, give a lifting action to the bulkhead and suspension system to make sure that the bouncing weight of the bulkhead is not carried by the suspension system.

There is a file wrapper estoppel which prevents infringement of claim 1.

Evans' Specification of Errors.

Evans, on pages 20 and 21 of its Brief, specifies eight errors of the Trial Court, all of which have their basis in alleged errors of fact of the Trial Court and not errors of law:

> "(a) The Court erred in restricting the Wells patent to the illustrated embodiment of the invention and in giving the claim language an artificially restricted interpretation to support a holding of non-infringement." (Br. p. 20).
>
> "(b) The Court, when comparing the language of the Wells patent claims with the accused constructions, erred in applying to the timing shaft

of certain of the accused constructions the claim language calling for a transverse 'bar' and using that misapplication of the claim to support a holding of non-infringement, when, in fact, the accused constructions incorporated another element which had the structural and functional characteristics of the 'bar' specified in the claims." (Br. p. 20).

"(c) The Court erred in concluding that the accused structures avoided infringement because they incorporated features in addition to the combination of elements claimed by Wells when those added features did not change or impair the function and co-action of the claimed elements." (Br. p. 20).

Asserted errors (a), (b) and (c) are directed to the Findings of non-infringement, Findings of Fact 28, 29, 30, 32, 33, 35, 37, 39, 40 and 41 [R. 394-398].

Infringement and Equivalency Are Questions of Fact.

In those instances in which there is a dispute as to the construction of the device of the patent in suit and the construction of the accused devices, infringement is clearly a question of fact. Factual findings are not to be disturbed unless clearly erroneous.

Stilz v. United States, 269 U.S. 144, 147;

Moist Cold Refrigerator Co. v. Lou Johnson Co. (C.A. 9, 1957), 249 F. 2d 246, 255;

Del Francia v. Stanthony Corporation (C.A. 9, 1960), 278 F. 2d 743, 748 (note 5).

"A finding of equivalence is a determination of fact. Proof can be made in any form: through

testimony of experts or others versed in the technology; by documents, including texts and treatises; and, of course, by the disclosures of the prior art. Like any other issue of fact, final determination requires a balancing of credibility, persuasiveness and weight of evidence. It is to be decided by the trial court and that court's decision, under general principles of appellate review, should not be disturbed unless clearly erroneous. * * *"

Graver Mfg. Co. v. Linde Co., 339 U.S. 605, 609, 610.

In *Moon v. Cabot Shops, Inc.,* 270 F. 2d 539, 545, this Court held that:

"The factual finding of the trial court that the accused devices are not equivalent to the patent claims, as so construed, is not to be disturbed unless clearly erroneous. Graver Tank & Mfg. Co. v. Linde Air Products Co., 339 U.S. 605, 610, 70 S.Ct. 584, 94 L.Ed. 1097. We find no clear error in the making of this finding."

A comparison of the testimony of witnesses Nickerson and Moorhead, witnesses who testified on behalf of Evans, with the testimony of witnesses Beemer, Chesnut, McCormick, Jr. and Erickson, witnesses who testified on behalf of Preco, clearly shows the many disputes as to the construction and operation of the patented device and the construction and operation of the accused Preco load dividers.

The dispute in that regard is also clearly apparent from Exhibits AZ-1, AZ-2 and AZ-3, the claim charts. Nickerson, the expert witness called by Evans, testified that all of the accused devices infringed each of the

claims of the patent in suit and applied the claims to the accused devices as typed on said charts.

Chesnut, the expert witness called by Preco, disputed Nickerson's testimony in many important respects. In those instances in which Chesnut found that an element of a claim was not present in the accused device he put the identifying "No" on the charts.

The Trial Court resolved any conflicts in favor of Preco.

Asserted error (d) reads as follows:

> "(d) The Court erred in concluding that the file wrapper of a subsequent patent obtained by Evans covering improvements over the Wells construction that are incorporated in some of Evans' commercial constructions contained admissions by Evans supporting Preco's contentions regarding differences between the accused load dividers and the structure of the patent in suit." (Br. pp. 20-21).

The file wrapper contents of the Erickson, *et al.* patent owned by Evans [Ex. 59] contains statements showing that Evans, when it was attempting to obtain a patent on its commercialized structure, carefully pointed out the very defects and differences on which Preco presented evidence and on which the Trial Court made findings in Preco's favor.

Also, Evans' witness Moorhead made the same admissions in open Court. (See Section entitled "The Admissions Against Interest in the File Wrapper of the Erickson, Moorhead, et al. Application, Exhibit 59, and the Admissions of Evans' Witness Moorhead").

There was a sharp conflict as to the significance of these admissions, but nevertheless, they are questions

of fact for the Trial Court's determination, not questions of law.

The Court resolved these differences in favor of Preco, and in its opinion found:

> "* * * And continuously in the patent—in the Patent Office proceedings—Evans has emphasized the substance and important differences between the device it is making and the Wells device." [Tr. 1387].

Asserted error (e) reads as follows:

> "(e) The Court erred in failing to hold that the Wells invention filled a long-felt need and achieved substantial commercial success." (Br. p. 21).

The question of whether or not Wells satisfied a long-felt need and achieved substantial commercial success is clearly a question of fact to be determined by the Trial Court. There was a substantial dispute in the evidence in that respect which the Trial Court resolved in Preco's favor.

Asserted error (f) reads as follows:

> "(f) The Court erred in concluding that because elements like those specified in the claims of the Wells patent were found separately in the prior art where each functioned alone as it did in the Wells combination, that the combination claimed was an unpatentable aggregation of old elements, when in fact, they co-act to produce a useful result not hitherto achieved in the prior art." (Br. p. 21).

Whether or not the elements used in a combination are new or old is a question of fact to be determined by the Trial Court. Whether or not the elements have

any different mode of operation or function is likewise determined by comparing the elements of the prior art with the elements of the patent in suit. Whether or not there is any new coaction is likewise a factual determination to be made by comparison. The question of whether the elements in the Wells aggregation of parts "co-act to produce a useful result not hitherto achieved in the prior art," is a question of fact to be determined factually by looking at the coaction between the prior art and the alleged combination of the patent in suit. Of course, since *Graham, et al. v. John Deere, et al.* the question of whether or not "a new or useful result" is achieved has nothing whatsoever to do with the question of invention under the obviousness Rule of 35 U.S.C. §103.[4]

Asserted error (g) reads as follows:

> "(g) The Court erred in concluding that it would have been obvious at the time the Wells invention was made to conceive the combination of elements claimed in the patent." (Br. p. 21).

As stated in detail in *Graham, et al. v. John Deere, supra,* the determination of obviousness requires three factual inquiries as we will discuss in detail under the Section entitled; "The Findings of Invalidity are correct and are supported by the evidence".

The first factual determination is scope and content of the prior art. Secondly, the differences between the claims of the patent in suit and the prior art; and, third, factual inquiry is the level of ordinary skill

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[4]*Graham, et al. v. John Deere Company of Kansas City, et al.; Calmar, Inc. v. Cook Chemical Company; Colgate-Palmolive Company v. Cook Chemical Company*, 383 U.S. 1, 15 L.Ed. 2d 545.

in the art to which the invention pertains. This level of ordinary skill is a factual determination which is made by looking at all of the patents as well as everything else which has been done in the art so as to determine what it is that constitutes the vast fund of human knowledge which anybody and everybody is entitled to use. The only legal part on the question on obviousness for the Court to determine is whether the differences amount to invention. In this case there is nothing for this court to decide in that respect because everything that the patent in suit did was common knowledge in the art and, therefore, there are no "differences" which must be or can be considered.

In any event, all of Evans' asserted errors in the case, including the Findings of Fact relevant to the 35 U.S.C.A., Section 103 question, are questions to which the "clearly erroneous rule" is clearly applicable.

In *Canadian Ingersoll-Rand Co. v. Peterson Products* (C.A. 9, 1965), 350 F. 2d 18, 25, 26, this Court held the clearly erroneous rule applicable to findings of fact relevant to the Section 103 question.

In this case, of course, the Court has resolved the conflicts in the evidence in favor of Preco.

Asserted error (h) reads a follows:

> "(h) The Court erred in failing to hold that the Wells patent is valid and is infringed by each of the accused constructions." (Br. p. 21).

This is a general catch-all assertion and deserves no special attention.

As previously stated, this Court, in *Canadian Ingersoll-Rand Co. v. Peterson Products* (C.A. 9, 1965), 350 F. 2d 18, at page 25, held that evidence such as in

this case "* * * is susceptible of varying interpretations and evaluations and gives rise to a choice of inferences, all of which could reasonably appeal differently to one fact finder than to another."

The Wells Patent in Suit No. 2,543,143.

The patent in suit, Exhibit A, discloses a "truck partition" which is movable into various positions longitudinally of the truck body and which may be swung out of the way when not in use. Movable partitions of this general type are old in the art. The truck partition disclosed in the patent in suit is used in connection with a truck body (see patent Figs. 1 and 3), having a bottom 12 and vertical side walls 18 and 20 having C-shaped longitudinal tracks 32 and 34 carried by the side walls. Extending transversely between these tracks is a nonrotatable C-shaped cross-bar 42 having brackets 46 secured to it which slide in and are guided by the tracks 32 and 34. Rollers 48 and 50 are supported by each bracket to reduce friction. The cross-bar or track *does not rotate* when moved along the rails, but as defined in claim 1 of the patent, the bar is *slidably* mounted on the rails for movement to selected positions along the rails. A partition 40 is supported from the cross-bar 42 by a bracket 54, having rollers 60 and 61 which engage within the C-shaped cross-bar 42, and which has a swivel or pivot part 56, 64 and 66, which permits the partition 40 to be pivotally moved around the vertical axis of the pivot and to be sidewardly moved along the cross-bar 42 to position the partition near the side walls 18 and 20.

The partition is locked in transverse position by a locking mechanism which includes openings 104 (referred

to in the patent as detents) formed in upper and lower longitudinal bars 100 and 102 secured to the side walls 18 and 20. The opposite vertical edges of the partition are provided with latches 80 resiliently held in extended position. When the gate is swung into a transverse position the latches 80 are retracted by moving the handle 92, and when released will enter vertically aligned pairs of openings 104, thus holding the gate or partition in transverse position. There is no locking action with the truck body bottom 12 nor with any top structure since the Wells patent does not contemplate a top structure [see Findings of Fact 10 and 11, R. 388-389]. Also, there is no locking of the gate in its "stored" position.

The Structure of the Wells Patent in Suit Has Never Been Produced and Is Not Suitable for Use in a Freight Car.

The Court, in its oral Opinion [Tr. 1387, 1388] held:

> "Now, a word or two about certain other issues. It is my view that the device disclosed by the Wells patent has never been produced for commercial use. It is my view also that Evans manufactured its device before it became aware of the Wells patent. * * *
>
> "I might say to you that because of the locking device as shown in Wells, and its failure to anchor this bulkhead at the corners and to lift some of the weight off the center suspension point, the Wells device would not, in my view, be suitable for use in a freight car for restraining the heavy loads encountered therein as it is disclosed and taught in the patent."

The Trial Court strongly rejected Evans' contention that its commercial structures embodied the Wells patent in suit and constituted commercial use of that patent.

In the Findings of Fact the Trial Court found that the Wells patent in suit "* * * has never been produced for commercial use." [Finding 27, R. 394]. The Trial Court also found "The side wall locking arrangement of the Wells, et al. patent in suit consisting of the horizontally sliding bolts and detents in the wall of the vehicle would be completely inadequate in a freight car environment when used with a bulkhead of the size and weight necessary for the freight car environment." [Finding 26, R. 394].

Furthermore, Evans, in connection with the prosecution of its Erickson, *et al.* Patent No. 3,209,707, Exhibit 59, admitted the gross inadequacies of the patent in suit as will be shown later in the Section entitled "The Admissions Against Interest in the File Wrapper of the Erickson, Moorhead, et al. Application, Exhibit 59, and the Admissions of Evans' Witness Moorhead".

The facts speak plainer than any argument. The Wells application was filed in June of 1947. It issued in February of 1951. It was acquired by Evans on July 1, 1959 [R. 157]; and, notwithstanding Evans' contention of a great public need, there is not one iota of evidence that the Wells structure was ever built or commercially used. The evidence produced in this case

shows it would have been unsatisfactory for use in freight cars.

In answer to Interrogatory 1 k of Plaintiff's First Set of Interrogatories, Exhibit 36, Evans answered that it had no knowledge or information as to "when was a device embodying the alleged invention disclosed and claimed in the patent in suit first successfully tested or used?" This Interrogatory and answer are as follows:

> "*Interrogatory 1.* With regard to the patent in suit, No. 2,543,143, please answer the following questions:
>
> * * * * *
>
> "k. When was a device embodying the alleged invention disclosed and claimed in the patent in suit first successfully tested or used?"
>
> "*Answer*: Defendant has no knowledge or information as to the matters inquired about in this interrogatory except for such information as is contained in Patent No. 2,543,143. * * *"

Also please note Evans' answer to Interrogatory 5(a) of Preco's First Set of Interrogatories, Exhibit 36, which reads as follows:

> "Interrogatory 5. (a) Has defendant ever constructed or sold a structure of the design shown in the drawings of the patent in suit, and, if so, set forth when and where."
>
> "*Answer*: (a) No."

Also see Interrogatory 1 of Preco's Third Set of Interrogatories, Exhibit 39, and the testimony of the witness Moorhead at Transcript 984.

Evans Made Its First DF-B Installation, Which Evans Contends Was Covered by the Patent in Suit, Many Months Prior to Any Knowledge of the Wells Patent in Suit.

In its oral Opinion the Trial Court found that Evans manufactured its DF-B load dividers before it became aware of the Wells patent [Tr. 1387]. Finding 8 reads:

> "Defendant manufactured its first DF-B load divider and installed it in a freight car in the middle of 1958 (TR. 194), which was before it became aware of the Wells patent in suit. (TR. 916 et seq.)." [R. 388].

The testimony of Moorhead [Tr. 916-917] and Byrne, Evans' Sales Manager [Tr. 194], is that the first Evans' DF-B installation that Wells would allegedly read on,[5] was made no later than the middle of 1958, and that the Wells patent first came to Evans' attention six months prior to the purchase of Wells by Evans on July 1, 1959 [Pre-Trial Conference Order, R. 157].

The Evans' load divider is in reality irrelevant to any issues of validity or infringement. The accused devices must be compared with the claims of the patent and not with the commercial device of the patent owner.

See: *Hartford-Empire Co. v. Obear-Nester Glass Co.* (C.A. 8, 1930), 39 F. 2d 769 at 771:

> "* * * So, commercial devices are not to be compared with commercial devices, but the accused commercial device is to be compared with the claims of the patent in dispute."

---

[5]Note, however, that the Trial Court found that this load divider is not within the Wells patent [Finding 27, R. 394].

Also see *Kromer v. Riegel Textile Corporation* (C.A. 7, 1955), 227 F. 2d 741, 743-744; *S. S. Kresge Co. v. Davies* (C.A. 8, 1940), 112 F. 2d 708, 709; and *Cincinnati Milling Machine Co. v. Turchan* (D.C., E.D., Mich., S.D., 1951), 101 F. Supp. 621, 632.

Oral Opinion of Trial Court on Issue of Validity.

In its oral Opinion with respect to the issue of validity, the Trial Court found at Transcript 1384 (after describing the Wells device):

> "Now, it has been proved to my satisfaction that every one of these characteristics were disclosed and adequately disclosed by the prior art. I don't find any spark of inventive genius in the combination. The combination seems to me to have been an obvious one, and I make the decision, of course, as of the date of the patent, and postulating the kind of a person with the kind of skills that the law requires me to do.
>
> "Now, of course, also in making this decision on the issue of validity, I am conversant with Appellate Court decisions * * * But my finding of obviousness is a firm one made with these Appellate Court requirements and decisions in mind."

The Trial Court's Findings of Fact on Invalidity.

The Trial Court made forty-two Findings of Fact [R. 387-399] and twenty-two Conclusions of Law [R. 400-403], on which it based its Judgment [R. 404-405] that the patent in suit and all of its claims are invalid; and Preco has not infringed any of the claims of the patent in suit by the manufacture, use or sale of the accused load dividers.

Findings 12 to 25 and Conclusions of Law 7 to 12 relate to invalidity.

In Finding 12 [R. 390] the Court found that "All of the elements of the Wells, *et al.* patent in suit and the cooperative relations therebetween are old and well known in the art".

Finding 12 then takes each element of claim 1 and specifies the prior art patents in which that element is shown.

Charts applying the prior art to the elements of Claims 1, 2 and 3 of the patent in suit are found in the Pre-Trial Conference Order, pages 11 to 15 thereof [R. 166-170].

In Finding 17 [R. 393] the Court made the finding that all of the elements of claims 2 and 3 of the patent in suit are found in the prior art as said elements and said prior art are set forth on pages 13, 14 and 15 of the Pre-Trial Conference Order [R. 169-170].

In Finding 13 [R. 391-393] the Trial Court found "Partitioning devices with many of the elements of the patent in suit were old prior to the filing of the Wells, *et al.* application of the patent in suit, * * *". Thereafter in subparagraphs (a) through (e), the Court specifies five prior art patents and describes the manner in which the partition is suspended in each of these patents.

In Finding 14 [R. 392] the Trial Court found that transverse beams of the general type shown by 42 of the Wells patent in suit, and commonly known as "bridge-crane type" load supporting means had been used in freight cars prior to the filing of the patent in suit and that these devices were capable of transport-

ing a load to any desired location within the car. The Court cited the Staiger Patent, Exhibit 2-P, the Lundborg Patent Exhibit 2-S, and the Deady Patent, Exhibit 2-G.

The Trial Court found that the transverse support or bridge-crane mounting of the Wells patent in suit "* * * does not take on a new quality or function by being brought into concert with the partition member of the patent in suit and their assembly does not result in an unusual or surprising result." [Finding 15, R. 392].

To illustrate the manner in which the prior art was so readily used by Wells, Preco made a series of composite reproductions of the elements used by Wells.

In Finding 16 [R. 392-393] the Trial Court found:

> "16. Ex. 31, a composite reproduction of the bridge-crane of Staiger No. 2,437,486 (Ex. 2-P) and the partition of Wells No. 1,646,604 (Ex. 2-H) illustrates that the bridge-crane mounting and partition member of the Wells, et al. patent in suit do not perform any different or additional functions in the aggregation than they did in their original environment. The results are not unusual or surprising. No more is derived from the assembly than might be reasonably expected as a sum of old ideas drawn from the public domain. Ex. 32 also illustrates a similar combination of the partition of the Jones Patent No. 1,803,760 (Ex. 2-I) with the bridge-crane of Deady Patent No. 1,622,574 (Ex. 2-G). Ex. 40 also illustrates a similar combination of the farm gate of Potter No. 226,102 (Ex. 2-R) supported on the bridge-crane of Staiger No. 2,437,486 (Ex. 2-P)."

Evans, at the trial, contended superiority in the ability of the partition of the patent in suit to store partitions parallel to and against the side walls of a freight car in any location along the side walls thereof. The Trial Court, however, rejected this contention as a basis of establishing patentability or invention as follows:

> "18. The Defendant contended at the trial that the patented structure is superior because the use of the bridge-crane suspension for the load divider partition of Wells Patent No. 1,646,604 (Ex. 2-H) resulted in the ability to store the partitions parallel to and against the side walls of the car in any location along the side walls of the car. It is nevertheless an assembly of old elements. Even if it were assumed that the patented load divider was superior in the above particular, such superiority is a mere matter of degree and does not constitute a new or surprising function or result." [R. 393].

Please note that in this Finding the Trial Court found that any *assumed* alleged superiority of the partition of the Wells patent in suit "* * * is a mere matter of degree and does not constitute a new or surprising function or result" [Finding 18, R. 393].

The evidence showed that Preco in 1941 manufactured load dividers as disclosed in the Wieden Patent, Exhibit 2-0, issued October 10, 1944 [See Finding 7, R. 388].

The Trial Court found it is obvious that if one wished to store the Wieden partition at any point along the

side walls of the car this could be accomplished by the use of a bridge-crane suspension of the prior art. Findings 19 to 25 find:

> "19. The Wieden partition (Ex. 2-0) provided lateral track means for storing the partitions at a single point on each of the side walls. It is obvious that if one wished to store the Wieden partition at any point along the side walls of the car this could be accomplished by the use of a bridge-crane suspension such as shown in the patents to Deady (Ex. 2-G), Staiger (Ex. 2-P) or Lundborg, et al. (Ex. 2-S)." [R. 393].
>
> "20. The patented device is no more than a small step forward in the gradual development and improvement of the load divider art." [R. 393].
>
> "21. The intended purpose of the prior art patents and the results obtained thereby, and the purpose and results obtained by the Wells, et al. load divider of the patent in suit, are substantially the same and are accomplished in substantially the same way. In so far as any differences in results or mode of operation between the prior art patents and the Wells, et al. load divider of the patent in suit are concerned, such differences are a matter only of degree and not of kind." [R. 393-394].
>
> "22. The prior art contains every element and every function of the Wells, et al. patent in suit. Each element and the function of each element of the Wells, et al. patent in suit is old, and there is no coaction between the elements any different than the coaction between the elements of the prior art." [R. 394].

"23. The Wells, et al. patent in suit discloses an unpatentable aggregation of old elements and not a patentable combination." [R. 394].

"24. The structure disclosed and claimed in the Wells, et al. patent in suit considered as a whole was obvious at the time that the invention was made to a person having ordinary skill in the load divider art." [R. 394].

"25. There is no evidence that some of the most pertinent prior art produced at the trial was considered by the Patent Office during the prosecution of the patent in suit, and the evidence is to the contrary." [R. 394].

The Load Dividers of Preco.

Preco manufactured movable adjustable partitions for freight cars in 1941, these structures comprising "* * * load dividers being intended to perform essentially the same function as the load dividers currently manufactured by Plaintiff." [Finding 7, R. 388]. Preco was forced to cease its manufacture of load dividers because of World War II, but restarted again in 1958. In July of 1959 Preco installed its load dividers as shown in Exhibit 48-A [Finding 7, R. 388].

There are five accused load dividers of Preco, namely:

Model BD-2 [Exs. 11, 12, 19, 20, AE-1, AE-2 and AF], see Finding 31 [R. 395];

Model BD-6 [Exs. AN-1 to AN-6], see Finding 33 [R. 396].

Models BD-6 and BC-3 are two of the load dividers which the Trial Court inspected and which

were demonstrated to the Trial Court on November 2, 1965 [Tr. 122, 139].

Model BC-3 [Exs. 7, 8, 16, AA and AB] see Finding 34 [R. 396];

Model BE-2 [Exs. 5, 6, 13, 14, 15, Y and Z], see Finding 36 [R. 397]; and

Model BC-4 [Exs. 9, 10, 17, 18, AC and AD], see Finding 38 [R. 397].

Typical of the Preco load dividers is Model BD-2 [shown in Exs. 11, 12, 19, 20, AE-1, AE-2 and AF]. This load divider includes a full width partition suspended by a swivel connection shown in the enlarged central view of Exhibit 12, the swivel connection being carried by the roller trolley located in the non-rotatable track numbered 451 in Exhibits 11 and 12. The track, in turn, is supported on a transversely oriented rotatable bar or axle 430, which has sprockets 431 mounted on its ends, the sprockets having teeth 433 engageable in openings or detents 426 of the pair of longitudinal rails 421. The rails are supported from the ceiling of the freight car as shown in the exhibits.

The sprockets and the transverse rotable bar rotate as a unit and automatically align the cross-bar and partition in an exact transverse plane. Finding 31 finds "* * * and the structure shown differs essentially from that disclosed and claimed in the Wells, *et al.* patent in suit. * * *" [R. 395]. This aligning action results from the fact that the cross-bar 430 and the sprockets 431 rotate as a unit and are "geared" to the longitudinal tracks by the teeth 433 coacting with the openings 426.

The load divider partition has bolts or double pronged locking pins 466 and 468 in its upper and lower four

corners which engage corresponding detents in the supporting rails 421 and floor rails 427 [see Exhibit 11]. Finding 31 finds that this is "* * * a construction which differs from the horizontally oriented bolts and detents in the side walls of the Wells, et al. construction." [R. 395].

In gate locking position, lower pins 468 project their prongs into locking apertures 429 of the lower rails and upper pins 466 project their prongs into locking apertures 425 of the upper rails. In gate releasing position, all of the locking pins are withdrawn from the rails. The gate is then freely movable about the car by rolling of shaft 430 along upper rails 420 and 421 and by rolling of roller structure 453 on member 451.

The gate locking pins are so arranged that when they are in locking position the entire weight of the gate is relieved from the cross-shaft 430, the trolley and associated parts. This is true whether the gate is locked in a transverse position or is locked in a stored position against a side wall of the freight car. Irrespective of the position in which the gate is locked all four locking pins at the four corners of the gate function to support the weight of the gate, thus relieving the moving parts from load and thus preventing severe jarring action and destruction which otherwise would occur.

In Finding 40 the Trial Court named three of the important differences between the patent in suit and the accused devices, namely, that the accused devices have:

(1) a rotating squaring bar having sprockets at the ends;

(2) rails having openings engageable by the sprockets and mounted on the ceiling rather than the wall and of different shape; and

(3) locking devices which operate in an entirely different manner in that the detents are in the rails rather than the walls.

In the Preco models the bottom bolts, when the mechanism is locked, give a lifting action to the bulkhead, and that is to make sure that the bouncing weight of the bulkhead is not carried by the suspension system.

These important differences in Preco's BD-6 model load divider were demonstrated and pointed out to the Trial Court during the inspection of the freight car having the BD-6 model on November 2, 1966 [Tr. 123-127].

Trial Court's Opinion on Non-Infringement.

The Trial Court's oral Opinion on Non-Infringement begins at Transcript 1384 and reads as follows:

> "Now, I would like to pass to the issue of infringement. On this issue, I have to start with two premises, since this is a combination patent involving a combination of old elements. First, all elements must be found in each of the accused devices, and the mode of operation must be the same.
>
> "Now, I have examined these devices, thought about them, compared them with the patent in issue, and it is clear to me that the mode of operation is certainly different. The accused devices are so different from the Wells device that it is like comparing apples and oranges. It is also clear to me that all of the elements are not found in

the accused devices. Even a liberal application of the doctrine of equivalents would not change the result.

"There is, of course, some doubt as to whether under these circumstances a liberal definition of equivalents should be used. But I say that even if I were to use it, the result would not be any different.

"There are real differences between the patented device and the accused device, it seems to me. These differences are certainly not the unimportant and insubstantial changes of a copyist such as discussed in Nelson vs. Batson.

"Let me mention specifically some of the differences that particularly impress me. The bar is different, the design of the bar as a timing device, as a rotating bar, is a most significant difference. The bar in the accused devices is different in that it is not, in my view, slidably mounted.

"The rails are different; different in design, function and location. They are not in at least most, if not all of the accused devices—and I will examine that question more carefully when the findings are submitted—but they are not carried by the side walls. They are used for a different purpose. The rails are not, in the Wells device, including in the accused devices, for the purpose of this guiding mechanism and locking.

"Now, No. 3, the locking device is vastly different, it seems to me. The locking at the four corners of the partition to the top and bottom of the car is far different from the side locking of Wells. Incidentally, the side locking of Wells, as

I understood the testimony in this case, would be completely inadequate to a freight car environment when used with a bulkhead of the size and weight of those embodied in the accused devices. Then, too, the adding of the element of the lifting of the weight as part of the locking devices is also in my view a significant difference.

"Next, of course, the detents are different. They are not carried in the accused devices by the walls. Of course, the locking is not side locking, but as I have indicated, is different."

Trial Court's Findings of Fact on Non-Infringement.

The Trial Court found that Preco's structures are so different from the Wells device that it is like comparing apples and oranges. Finding 28, reads as follows:

> "28. The accused load dividers made and sold by Plaintiff are designed for use in freight cars where the requirements are much more exacting than the requirements for trucks of the type shown in the Wells, et al. patent in suit. The accused devices are so different from the Wells, et al. device that it is like comparing apples and oranges."[6] [R. 394].

The Trial Court found that Preco's structures are diferent constructions from that of the patent in suit. The elements are different, the coaction between the elements are different, and the structures have a different mode of operation from the load divider dis-

[6]The detailed facts and the law of non-infringement will be argued in the Section entitled "The Findings of Fact on Non-Infringement are Correct and are Supported by the Evidence".

closed in the patent in suit. This Finding is 29 [R. 395] which states:

> "29. The Plaintiff's structures charged to infringe are different constructions from that of the Wells, et al. patent in suit. The elements are different, the coaction between the elements are different, and the structures have a different mode of operation from the load divider disclosed in the patent in suit."

Finding 30 [R. 395] states:

> "30. All of the elements of each of the claims of the patent in suit are not found in the accused devices and the claims are not infringed. Even a liberal application of the doctrine of equivalents would not change the findings of non-infringement."

Exhibits AZ-1, AZ-2 and AZ-3.

All of the typed material on Exhibits AZ-1, AZ-2 and AZ-3, the claim charts was prepared by Evans. It applies the language of claims 1, 2 and 3 respectively of Wells to the patent disclosure and other accused structures. Evans' expert Nickerson testified with respect to such alleged infringement [Tr. 600-666, 682-704, 752-758, 770-793 and 799-812].

The testimony of Nickerson is in direct conflict with the testimony of Preco's expert Chesnut who testified, at Transcript 1099-1104, 1113-1130, 1145, 1146, and 1244-1257, as to the elements of claims 1, 2 and 3 which are not contained in the accused models. Where the witness Chesnut found an element or a limitation was not present he put an identifying "No" in ink on the chart. The Trial Court weighed the conflicting evidence and decided the conflicts in favor of Preco,

holding that none of the claims were infringed by any of the accused models.

In Finding 31 [R. 395], the Trial Court describes Preco's Model BD-2 Load Divider [Exs. 11, 12, 19, 20, AE-1, AE-2 and AF]. In Finding 32 [R. 395], the Trial Court finds that Model BD-2 does not have:

> 8 of the 12 elements or limitations of claim 1 of the patent in suit, as shown on Exhibit AZ-1;
>
> 8 of the 11 elements or limitations of claim 2 of said patent, as shown on Exhibit AZ-2; or
>
> 11 of the 15 elements or limitations of claim 3 of the patent in suit, as shown on Exhibit AZ-3.

In Finding 33 [R. 396], the Trial Court finds that Preco's BD-6 Model Divider (Photographs AN-1 to AN-6) is substantially the same as Model BD-2, except that the longitudinal side rails are mounted on the side walls of the car, and that with that exception, the Findings with respect to non-infringement are the same as for Model BD-2.

Preco's Model BD-6 load divider is one of the load dividers that the Trial Court inspected and which was demonstrated to the Trial Court on November 2, 1965 [Tr. 122].

Findings 34, 36 and 38 [R. 396-398] describe Preco's load dividers Models:

> BC-3 [Exs. 7, 8, 16, AA and AB];
>
> BE-2 [Exs. 11, 12, 19, 20, AE-1, AE-2 and AF];
>
> BC-4 [Exs. 9, 10, 17, 18, AC and AD];

respectively. Model BC-3 is another of the load dividers which was demonstrated to the Court on November 2, 1965.

Findings 35, 37 and 39 [R. 396-398] specify the elements or limitations of claims 1, 2 and 3 of the patent in suit, as shown in the infringement charts Exhibits AZ-1, AZ-2 and AZ-3, that are not found in these BC-3, BE-2 and BC-4 models, respectively.

The Trial Court picked out the more important differences between the device of Wells and Preco's accused devices in Finding 40 (See this Br. p. 27, *supra*).

In Finding 41 [R. 398-399] the Trial Court found that there is file wrapper estoppel which prevents infringement of claim 1. Claim 1 of the patent in suit had been amended to insert language which limited this claim to a structure in which the transverse bar is slidable and cannot be construed to cover a transverse rotatable bar having sprockets secured to the ends thereof and which is rotatable.

Finding 41 [R. 398-399] reads as follows:

> "41. Claim 1 of the Wells, et al. patent in suit, was claim 1 of the application. This claim as originally written, claimed that the ends of the crossbar were movable on the rails. The claim was rejected by the Examiner and it was thereafter amended to cancel the word 'movable' and substitute—slidably mounted on said rails for movement—. By virtue of the amendment to claim 1, the claim was limited by the principle of file wrapper estoppel to a structure in which the transverse bar is slidable and cannot be construed to cover a transverse rotatable bar having sprockets secured to the ends thereof and which is rotatable."

Please note the subsection entitled "File Wrapper Estoppel", *infra,* p. 62.

The Admissions Against Interest in the File Wrapper of the Erickson, Moorhead, Et Al. Application, Exhibit 59, and the Admissions of Evans' Witness Moorhead.

Some of the most powerful arguments for Preco's contentions of non-infringement lie on the admissions of Evans as set forth in the File Wrapper Exhibit 59 of the Erickson, Moorhead, *et al.* Patent No. 3,209,707, which were corroborated by the witness Moorhead. These admissions and their corroboration are 180° out of phase with the posture assumed by Evans during the trial of this action.

Moorhead testified that he is the General Manager of Research, Development and Patents for Evans, that he became Director of Patents about 1952 and the Director of Engineering about 1958 [Tr. 867, *et seq.*,]. He is a co-inventor of Erickson, Moorhead, *et al.* Patent No. 3,209,707.

These admissions in the file wrapper of Exhibit 59 were made by the same attorneys that represent Evans in this action.

The Trial Court, in referring to Exhibit 59 stated:

> "Exhibit 59, gentlemen, is significant in my mind. That is the new patent issued to Evans on its device. And continuously in the patent—in the Patent Office proceedings—Evans has emphasized the substance and important differences between the device it is making and the Wells device." [Tr. 1387].

Finding of Fact 42, reads as follows:

> "42. The admissions contained in the file wrapper (Ex. 59) of Erickson et al. Patent No.

> 3,209,707 assigned to the Defendant, are admissions against interest supporting Plaintiff's contentions of the differences between the accused load dividers and the structure of the patent in suit." [R. 399].

Moorhead Testified That the Wells Structure, Preco Structures and Evans Structures All Present Different Mechanical Means.

Moorhead testified that he agreed from the beginning that the Wells' structure, the Preco structures, and the structure of the Erickson, Moorhead application, Exhibit 59, present different mechanical means. This testimony is at Transcript 961, lines 8-11, and reads as follows:

> "* * * I think I have agreed from the beginning of their structure, your structure and all of these structures present different mechanical means * * *."

Admission re Locking Pins Carried by the Bulkhead at the Top and Bottom Thereof and Rails Having Means Cooperating With the Locking Pins.

On page 66 of the file wrapper of the Erickson, Moorhead, *et al.* patent, Exhibit 59, Evans clearly admitted that Wells does not disclose locking pins carried by the bulkhead at the top and bottom thereof, and that it clearly does not describe that the rails have means spaced therealong for cooperation with the locking pins at the top of the bulkhead. This admission reads as follows [Ex. 59, p. 86]:

> "Reconsideration and withdrawal of the rejection of Claims 1 to 3, inclusive, as failing to define

patentable novelty over the patent to Wells et al. are respectfully requested. *The assignee of the present applicants is thoroughly familiar with the Wells et al. patent since it is also the owner of that patent. The Wells et al. patent clearly does not disclose locking pins carried by the bulkhead at the top and bottom thereof and further, it clearly does not disclose that the rails have means spaced therealong for co-operation with the ones of the locking pins at the top of the bulkhead."* (Emphasis added).

Moorhead agreed with the foregoing statement [Tr. 956-957].

This is one of the important differences found by the Trial Court in its oral Opinion [Tr. 1386].

Admission That Dual Function of Rails Not Taught in Wells Patent.

In Exhibit 59, at pages 66 and 84, Evans stressed that the rails in Exhibit 59 perform the dual function of supporting the ends of the trolley beam and of having means spaced along the rails for cooperation with the locking pins at the top of the bulkhead. Evans admitted: "This dual function is clearly not taught or suggested in Wells, et al.":

> "* * * *applicants' rail performs the dual function of supporting the ends of the trolley beam and of having means spaced along the rails for co-operation with the ones of the locking pins at the top of the bulkhead. This dual function is clearly not taught or suggested in Wells et al."* (Emphasis added, p. 66).

> "The present applicants have also provided an improved rail assembly which is very rugged and durable and which overcomes problems which have been encountered in previous rail assemblies. In the present applicants' rail assembly, the angle which includes a flange having perforations adapted to provide a supporting track for a sprocket wheel also cooperates with the upper and lower sections of the assembly to provide a box section contributing to the great strength of the rail assembly. It is respectfully submitted that the only teaching of such a rail assembly is in the present application. * * *" (p. 84).

Moorhead, when asked if he agreed with that statement, testified at Transcript 957:

> "A The fact that the dual function, the one part being performed by another, I agree, I don't believe it is necessarily taught; certainly not by the drawings. I think all we can say here is that the principle of operation was taught, and means for accomplishing it were taught."

This is another of the important differences found by the Trial Court.

Admission That Disclosure of Wells Patent Inconsistent With Respect to Moving Bulkhead to a Position Parallel Against Side Wall.

At pages 66, 67 and 69 of Exhibit 59, Evans admitted that the disclosure of the Wells patent was inconsistent with respect to the moving of the bulkhead

to a position parallel to and against the side walls. These admissions are as follows:

> "Reconsideration and withdrawal of the rejection of Claims 4 to 7, inclusive, as failing to define patentable novelty over Wells et al. in view of Nissen and Lloyd are respectfully requested. *At the outset it is noted that the disclosure of the Wells patent appears to be inconsistent with respect to the moving of the bulkhead to a position parallel to and against the side walls,* in that *Figure 4 seems to indicate that this can be done,* while Figure 9 *shows that the roller bracket 54 within the track bar 42 is substantially wider than the socket member 56 and it appears that movement of the bulkhead to the position illustrated in Figure 4 would result in one of the rollers 60 coming out of the end of the track bar 42".* (pp. 66-67—emphasis added).
>
> "Claims 13 and 14 are directed to a combination including a pair of bulkheads and the anchor plates as there recited, enabling the bulkheads to be stored in parallel position closely adjacent either doorway, as illustrated in Figure 3. The additional anchor places referred to in these claims are the anchor plates 400 identified in Figure 3. There is clearly no suggestion of this feature of the present applicants' construction in either Wells, Adler et al. or Wieden." (p. 69).

Admission That Wells Track Bar 42 Is an Entirely Different Construction Than a Rotating Squaring Bar Having Sprockets on the Opposite Ends Thereof.

In Exhibit 59 Evans admitted that the transverse track bar 42 is of entirely different construction than the construction shown in Exhibit 59 (p. 70):

> "* * * *The Wells patent is pertinent only in that it shows a trolley beam. The trolley beam, called a track bar (42) in Wells, is, however, of an entirely different construction than the present applicants' and its function is similar only in the broadest sense, that it supports the bulkhead for movement longitudinally of the track bar, and that the track bar is itself movable longitudinally of the truck body."* (Emphasis added).

Moorhead agreed with that statement, and testified at Transcript 961:

> "A The fact that Wells discloses this only in the broadest sense, yes, I think I have agreed from the beginning of their structure, your structure and all of these structures present different mechanical means of accomplishing the same result."

Admission That Sprocket Wheels Mounted on Transverse Bar and Held Against Rotation Differed From Wells Construction.

In Exhibit 59 Evans admitted that sprocket wheels mounted on the transverse bar and means for holding them against rotation relative to each other differed from Wells in which the rods 44 carry rollers freely rotatable thereon which are in no way interconnected.

> "* * * These claims are also specifically limited to a construction including sprocket wheels mounted

> on the beam for rotation relative thereto and interconnected by means holding the sprocket wheels against rotation relative to each other. This language also further distinguishes from the Wells et al. construction in which the rods 44 carry rollers 46 freely rotatably thereon which are in no way interconnected." (pp. 70-71).

Moorhead agreed that the rollers present a different method of keeping the bar square than Wells had [Tr. 962].

This is another of the important differences found by the Trial Court in its oral Opinion [Tr. 1385].

Exhibit 59 Is an Admission Against Interest.

At the Trial, counsel for Evans objected to the examination of Moorhead with respect to the statements in Exhibit 59. Counsel for Evans contended that Preco was asking for what amounts to hearsay testimony and that the arguments in Exhibit 59 were merely arguments of the patent solicitor who was seeking to persuade the Patent Office that it should grant a patent on this construction [Tr. 954, 981]. Counsel for Evans admitted that the Erickson, *et al.* application, Exhibit 59, was prosecuted on behalf of and owned by Evans [Tr. 955]. The Trial Court held that the statements in Exhibit 59 clearly constitute admissions against interest.

This Court in *Canadian Ingersoll-Rand Co. v. Peterson Products, supra,* at page 25, held as follows:

> "* * * Moreover, there is substantial authority for the proposition that it is appropriate to consider the actions and statements against interest of the

inventor or patent owner in construing the scope of a patent. See Jungersen v. Baden, 2 Cir., 166 F.2d 807, 809, aff'd 335 U.S. 560, 69 S.Ct. 269, 93 L.Ed. 235; Timken Detroit Axle Co. v. Cleveland Steel Prod. Corp., 6 Cir., 148 F.2d 267, 270."

See also *Foster Metals Products v. Jacoby-Bender, Inc.* (C.A. 1, 1958), 255 F. 2d 869 at 871, Footnote 1.

On pages 44 and 45 of its Brief Evans argues that Finding 42 was clearing erroneous both because the arguments in no way indicate that the accused structures do not infringe the Wells, *et al.* patent and because in any event, this type of thing is not a proper admission against interest and should properly have been excluded. The differences stressed by Evans in Exhibit 59 were in accord with Moorhead's testimony in this case and some are included in the important differences found by the Court in its oral opinion [Tr. 1385-1386]. The case cited by Evans on page 45 of its Brief is clearly *contra* to the decision of this Court cited above.

The Findings of Invalidity Are Correct and Are Supported by the Evidence.

Preco's expert witness Chesnut analyzed each of the prior art patents [Tr. 1034-1089], pointing out their construction and mode of operation. It was found that each and every element and each and every function was old. Furthermore, the testimony shows that all Wells did was to combine elements old in the art and when they combined them the elements were the same, the functions were the same, and the coaction was the same. To illustrate how simple it was to combine the elements of the prior art, colored Exhibits 31, 32 and 40 were prepared. Preco's expert Chesnut carefully and

thoroughly explained how the parts were combined and how they functioned.

It is a well established principle of law that to invalidate a claim it is not necessary that all of the elements be found in one prior patent. It is sufficient if all of the elements are found in a number of prior art patents. See *Eagle, et al. v. P. & C. Hand Forged Tool Co.* (C.A. 9, 1935), 74 F. 2d 918, 920 and *Schmeiser v. Thomasian* (C.A. 9, 1955), 227 F. 2d 875, 877.

Likewise, the law is well established that assembling an aggregation of elements is not a patentable invention. See:

> *Lincoln Engineering Co. v. Stewart-Warner Corp.*, 303 U.S. 545;
>
> *Great Atlantic & Pacific Tea Co. v. Supermarket Corp.*, 340 U.S. 147;
>
> *Bergman v. Aluminum Lock Shingle Corp. of America* (C.A. 9, 1957), 251 F. 2d 801;
>
> *Kwikset Locks v. Hillgren* (C.A. 9, 1954), 210 F. 2d 483;
>
> *Oriental Foods v. Chun King Sales* (C.A. 9, 1957), 244 F. 2d 909;
>
> *Continental Connector Corp. v. Houston Fearless Corporation* (C.A. 9, 1965), 350 F. 2d 183;
>
> *Bliss v. Gotham Industries, Inc.* (C.A. 9, 1963), 316 F. 2d 848, 850;
>
> *Pressteel Company v. Halo Lighting Products, Inc.* (C.A. 9, 1963), 314 F. 2d 695, 698, 699.

Since the claims of Wells, *et al.* are directed to an assembly of elements the caution recommended in the

Great Atlantic & Pacific Tea Co. v. Supermarket Corp. case, *supra* should be followed, namely, the Court should scrutinize combination patent claims with a care proportionate to the difficulty and *improbability* of finding an invention in an old assembly of elements. As in the *Great Atlantic & Pacific Tea* case, we have a situation in our present litigation in which the effect of the patent is to subtract from the fund of useful knowledge that which was previously freely available to skilled artisans. Also see

> *Bergman v. Aluminum Lock Shingle Corp. of America, supra;*
>
> *Kwikset Locks v. Hillgren, supra;*
>
> *Continental Connector Corp. v. Houston Fearless Corp., supra.*

Evans most certainly has not sustained its burden on appeal to establish that the Findings of Fact and Conclusions of Law are clearly erroneous. Nevertheless, Preco will briefly point out Wells did nothing more than utilize the fund of knowledge freely available to everyone and did nothing more than exercise the level of skill of persons in this art.

In Exhibit 40 Preco showed how simple it was to combine the teachings of Staiger, Exhibit 2-P and of Potter, Exhibit 2-R. The Potter arrangement consists of a transverse bar b from which a trolley g is hung, the lower part of the trolley g having a swivel bolt h. From the bolt h is hung the gate or partition consisting of horizontal bars c and the vertical bars d. It will be seen that the entire gate may be swivelled or pivoted on its pivot h as shown in Fig. 2 of the Potter patent, and when in this swivel position the entire assembly may be moved to either of the posts a, which act as the

side walls, the trolley g freely rolling on the transverse bar b. Preco's expert witness Chesnut testified to this construction and operation [Tr. 1107 *et seq.*].

The two posts a have recesses u which perform the same functions as the detents of Wells, *et al.* There are horizontally movable latch bars u which, as shown in the right-hand side of Exhibit 40, may be extended to engage in the recesses u in order to lock the gate in a transverse or closed position.

Also Preco's expert witness Chesnut testified with regard to Exhibit 40, starting on 1093 of the Transcript.

So far as the functioning of the gate is concerned, it makes no difference whether the parts a are posts or whether they are long walls. Evans complains that the partition of Potter is from an non-analogous art. It did not so complain before the Lower Court and its present complaint may be taken as a confession of the extreme pertinency of this referencce. The alleged Wells invention is a moveable partition which may be moved from a closing position into a stored position against a wall. Now, whether this partition is in a freight car or in a truck, or used in closing and opening or passage in any other structure is immaterial. As stated by the Supreme Court in the case of *Altoona Theatres v. Tri-Ergon Corp.*, 294 U.S. 477, wherein they found a flywheel is a flywheel wherever you use it and the Court held there was no invention in applying a flywheel in a motion picture machine.

As cogent evidence that Potter Exhibit 2-R is pertinent, we refer your Honors to the Wells Patent No. 1,646,604, Exhibit 2-H, directing your attention

first to the fact that the Wells patent is C. H. Wells, who is one of the co-inventors of the patent in suit. In his earlier patent he makes it clear that "* * * The partition will also be found to be useful in stock yards and on stock farms since it affords a convenient device for dividing a pen into small or large compartments when it is desired to keep some of the animals separate from the rest for special treatment or rations." (p. 2, right-hand column, lines 99-105).

Wells alleged invention is making the cross-bar such as b of Potter movable. In other words, it is supposed to involve invention to put wheels on the end of a bar. There is about as much invention and ingenuity here involved as putting casters on a bed.

There are many instances in the art where cross-bars or cranes are mounted on parallel tracks adjacent the side walls of a freight car and using wheels whereby the crane or cross-bar is slidable along the tracks. Such patents are Moriarty, Exhibit 2-D, Harris, Exhibit 2-J, Angell, Exhibit 2-K and others.

In Exhibit 40 we have chosen Staiger, Exhibit 2-P, as the patent to supply the wheels 36 and the longitudinal tracks 30.

The testimony shows that with an arrangement such as that of Exhibit 40 all of the functions of Wells are performed. There is certainly no new or different coaction between the wheels 36 and track 30 brought into being because it supports a cross-bar which, in turn, happens to support a partition or gate.

With each and every part and function being present there were, in reality, no differences for the Trial Court to make an evaluation as to whether or not invention

was involved. The results accomplished were not unusual or surprising such as is required by the *Continental Connector Corp. v. Houston Fearless* case, *supra,* or the other Ninth Circuit cases referred to heretofore.

If there were any testimony to the contrary of that of Chesnut, the conflict has been resolved in favor of that of Chesnut.

> "* * * We are not to re-evaluate conflicting expert testimony. Graver Tank & Mfg. Co. v. Linde Air Prods. Co., supra; Carolina Lee Knitting Co. v. Johnson & Johnson, 275 F.2d 91 (4th Cir. 1960)."
>
> *Continental Connector Corp. v. Houston Fearless Corp.,* 350 F. 2d 183, 190.

A second illustration is Exhibit 31 testified to by Preco's expert witness Chesnut, starting at Transcript 1111. In this Exhibit we have combined the disclosure of Staiger, Exhibit 2-P and the disclosure of the Wells patent, Exhibit 2-H. All of the elements, all of the functions, all of the co-actions are present. This illustration clearly shows that all Wells, did was to use the vast fund of public knowledge, and what they did was obvious "* * * as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art * * *" (15 L. Ed. 2d 554).

A third illustration is that of Exhibit 32, which combines Deady, Exhibit 2-G and Jones, Exhibit 2-I. This is just another illustration to show how extensive was the prior art and how many different things were available to Wells. He testified that the elements of Deady arranged in the composite of Exhibit 32, would function in the "* * * same way as they did in the original structures without any change in the function

of the elements", and that the structure shown in Exhibit 32 would function in substantially the same way as the device of the patent in suit [Tr. 1112-1113].

The Trial Court's decision of invalidity was based on Findings of Fact 12 to 25 [R. 390-394]. Please note the Section entitled "The Trial Court's Findings of Fact on Invalidity", *supra*. These Findings of Fact are supported by substantial evidence. In addition to the testimony of Chesnut, Mr. Beemer testified that he had been Chief Engineer of Preco, of his many years experience in the railroad supply field, with respect to Exhibits 42-A, B, C, and D, 43-A, B, and C, 45-A, B, and C, and 48-A, B, C and D, that Preco had produced since 1940, and with regard to the development of the Preco load dividers in suit. He also testified with regard to Staiger Patent No. 2,437,486, Exhibit 2-P and Wells Patent No. 1,646,604, Exhibit 2-H, and that it would be obvious to combine relevant portions of Staiger with relevant portions of Wells Patent No. 1,646,604, if you wanted to move the bulkhead of the first Wells patent to the side [Tr. 383-391].

The testimony of Chesnut and Beemer with respect to the prior art and the composite structures shown in Exhibits 31, 32 and 40 stands substantially uncontroverted.

Evans contention that the travelling beam crane art is "* * * believed to be non-analogous and certainly there is nothing in the prior art that suggests that a portion of a travelling beam crane be combined with a portion of any prior bulkhead construction for any purpose * * *" (Br. p. 61) is clearly without merit.

In addition to the load supporting devices of the bridge-crane type in freight cars found to be old by

the Court prior to the filing of the patent in suit specified in Finding 14 [R. 392], such load supporting devices are shown in the following patents:

Harris No. 1,825,452, Exhibit 2-J

Jones No. 2,160,870, Exhibit 2-L

Also please note in the Erickson, Moorhead, *et al.* file wrapper of Patent No. 3,209,707 [Ex. 59] "* * * the rails supporting the trolley beams 38 and 40 * * *" are referred to as "crane rails" [Ex. 59, p. 7, lines 11, 13, 15, 28 and 30, p. 8, and other places].

Evans argues that the assembly of the patent in suit accomplishes new results (See Evans Br. p. 65). Preco denies that it accomplishes any new results. It is just an accumulation of old results because additional parts are added, but even though new results were accomplished this would not involve invention. This point was decided by the Supreme Court of the United States in the case of *Graham, et al. v. John Deere Company of Kansas City, et al*; *Calmar, Inc. v. Cook Chemical Company; Colgate-Palmolive Company v. Cook Chemical Company,* 383 U.S. 1, 15 L. Ed. 2d 545. In that case there were petitions from separate Circuits, the Fifth and the Eighth—one Circuit holding that invention was present because there was a "new result", and another Circuit holding that invention was not present because there was "no new result". The Supreme Court rejected the decisions of both of the Lower Courts on the grounds that the wrong test was made.

> "* * * In 1955, the Fifth Circuit had held the patent valid under its rule that when a combination produces an 'old result in a cheaper and otherwise more advantageous way,' it is patentable.

Jeoffroy Mfg., Inc. v. Graham, 219 F2d 511, cert. denied, 350 US 826, 100 L ed 738, 76 S Ct 55. In 1964, the Eighth Circuit held in the case at bar, that there was no new result in the patented combination and that the patent was, therefore, not valid. 333 F2d 529, reversing 216 F Supp 272. We granted certiorari, 379 US 956, 13 L ed 2d 553, 85 S Ct 652. Although we have determined that neither Circuit applied the correct test, we conclude that the patent is invalid under § 103 and, therefore, we affirm the judgment of the Eighth Circuit." (15 L. Ed. 2d 545, 549).

The Supreme Court held that under 35 U.S.C. §103 it was necessary to make three factual determinations and against such a factual background the obviousness or non-obviousness of the subject matter must be determined.

"While the ultimate question of patent validity is one of law, A. & P. Tea Co. v. Supermarket Corp., supra, 340 US at 155, 95 L ed at 168, the § 103 condition, which is but one of three conditions, each of which must be satisfied, lends itself to several basic factual inquiries. Under § 103, the scope and content of the prior art are to be determined; differences between the prior art and the claims at issue are to be ascertained; and the level of ordinary skill in the pertinent art resolved. Against this background, the obviousness or non-obviousness of the subject matter is determined. Such secondary considerations as commercial success, long felt but unsolved needs, failure of others, etc., might be utilized to give light to the circumstances surrounding the origin of the subject mat-

> ter sought to be patented. As indicia of obviousness or nonobviousness, these inquiries may have relevancy. See Note, Subtests of 'Nonobviousness,' 112 U Pa L Rev 1169 (1964)." (15 L. ed. 2d 556).

This decision of the Supreme Court is a definite recitation of the law such as has been applied by this Court in many cases wherein this Court has held that no invention is involved where the inventor merely used ideas which were drawn from the existing fund of public knowledge and produced results which would be expected by one skilled in the art. See *Continental Connector* case, *supra* and *Monroe Auto Equipment Company v. Superior Industries, Inc.* (C.A. 9, 1964), 332 F. 2d 473.

Evans definitely has not made any explanation to this Court as to the scope and content of the prior art, as to the differences between the prior art and the claims, or as to the level of ordinary skill in the pertinent art. All of its arguments as to "new result" are of no value whatsoever because they are, as held by the Supreme Court, "the wrong test".

Evans failed to make any showing of any unusual or surprising result. The necessity of such a factual showing is emphasized by the Supreme Court in *United States v. Adams,* 15 L. Ed. 2d 572, 148 U.S.P.Q. 479, which was a decision handed down by the Supreme Court simultaneously with the *Graham, et al. v. John Deere, et al.* decision. In *United States v. Adams* it was held that the subject matter of the Adams patent was not obvious and that the patent was valid because:

> 1. "* * * the operating characteristics of the Adams battery have been shown to be unexpected

and to have far surpassed then existing wet batteries. * * *" (148 U.S.P.Q. 483)

2. "* * * Despite the fact that each of the elements of the Adams battery was well known in the prior art, to combine them together as Adams did required that a person reasonably skilled in the art must ignore * * * long accepted factors, [which] when taken together, would, * * * deter any investigation into such a combination * * *" (148 U.S.P.Q. 483, 484)

3. "* * * at the time Adams perfected his invention noted experts expressed disbelief in it. * * *" (148 U.S.P.Q. 484).

It should be remembered that the most important references relied on by Preco were not cited by the Patent Office and, therefore, the presumption of validity of the patent is greatly weakened."

Jaybee Mfg. Corp. v. Ajax Hardware Mfg. Corp. (C.A. 9, 1961), 287 F. 2d 228, 229;

Pressteel Company v. Halo Lighting Products Inc. (C.A. 9, 1963), 314 F. 2d 695, 697.

As stated in *Monroe Auto Equipment Company v. Superior Industries, Inc.* (C.A. 9, 1964), 332 F. 2d 473 at 481:

"* * * The existence of but one pertinent example of unconsidered prior art is not only sufficient basis to dissipate the presumption of validity (Pressteel Co. v. Halo Lighting Products, Inc., supra; Jaybee Mfg. Corp. v. Ajax Hardware Mfg. Corp., supra), but may render the patent invalid."

From the foregoing it is clear that the claims are invalid because what Wells did does not meet the

standard of invention as required by the Supreme Court in the *Great Atlantic & Pacific Tea Co. v. Supermarket Corp.* case, *supra,* and by the following Ninth Circuit cases:

Continental Connector Corp. v. Houston Fearless Corp., supra;

Bergman v. Aluminum Lock Shingle Corp. of America, 251 F. 2d 801;

Kwikset Locks v. Hillgren, supra.

The Findings of Fact on Non-Infringement Are Correct and Are Supported by the Evidence.

All of Elements of Any Claim Are Not Found in Any Accused Device.

Re. Findings of Fact 30, 32, 33, 35, 37 and 39.

As to non-infringement because all of the elements of any of the claims are not found in any of the Preco devices, we have testimony of Evans' expert Nickerson that there is infringement, and this is found on pages 600-666, 682-704, 752-758, 770-793, and 799-812 of the Transcript with reference to claim charts Exhibits AZ-1, AZ-2 and AZ-3. All of the typed material on those charts was inserted by Evans and testified to by Nickerson. This testimony was sharply denied by Chesnut who testified [Tr. 1099-1104, 1113-1130, 1145, 1146, 1244-1257], as to the elements of claims 1 to 3, which are not contained in the accused structures. Where the witness Chesnut found an element was not present he put the identifying "No" on the chart. The Trial Court weighed the conflicting evidence and decided the conflicts in favor of Preco, holding that none of the claims were infringed by way of the accused structures.

The Findings of Fact that all of the elements of any of the claims are not found in the accused devices are Findings numbered 30, 31, 32, 35, 37 and 39. [R. 395-398].

As to the elements absent from the Preco structures, as found by the Trial Court as testified to by Chesnut [the letter on the left-hand side of the element refers to the letter corresponding to the element in the claim charts, Exhibits AZ-1, AZ-2 and AZ-3]:

As to Claim 1 [Ex. AZ-1]

The accused structures do not have:

(d) a row of detents carried by at least one of said walls

(e) oppositely disposed rails carried by said walls

(f) above said detents

(g) a bar disposed between and supported by said rails, the ends of said bar being slidably mounted on said rails for movement to selected positions with respect to the longitudinal length of said rails.

(h) said rails being constructed for guiding such movement

(j) a pivotal connection between said member and said bar for suspending one from the other and for permitting said member to turn into positions transverse and parallel with respect to said walls at desired times

(k) means slidably mounting the said pivotal connection on the bar for longitudinal travel of said connection and partition member on the bar,

(l) and means cooperative with said detents carried by said partition member for maintaining said partition member in a position transverse with respect to said walls.

As to Claim 2 [Ex. AZ-2][7]

The accused structures do not have:

(c) tracks, C-shape in cross section

(d) carried by the upper parts of the side walls

(e) a transverse bar channel-shape in cross section extended between the tracks

(f) means movably mounting the ends of the transverse bar in the tracks

(h) a bracket positioned between the said partition and transverse bar

(i) means movably mounting the bracket in the bar

(j) means pivotally suspending the partition from the bar whereby with the bracket positioned at one end of the bar the partition may be positioned against the inner surface of a side wall of the vehicle body

(k) and locking means on an edge of said partition positioned to engage a side wall of the vehicle body for retaining the partition in a position extended across the said vehicle body.

As to Claim 3 [Ex. AZ-3][8]

The accused structures do not have:

(c) tracks, C-shape in cross section

---

[7]Claims 2 and 3 of the patent are not charged to be infringed by Model BE-2.

[8]Claims 2 and 3 of the patent are not charged to be infringed by Model BE-2.

(d) carried by the upper parts of the side walls

(e) a transverse bar, channel shape in cross section, extended between the tracks

(f) rollers journaled on the ends of the transverse bar and positioned in the tracks for movably mounting the bar in the tracks

(h) a bracket positioned between the partition and the bar

(j) a swivel joint pivotally suspending the partition from the bar whereby with the bracket located at one end of the bar the partition may be positioned against the inner surface of the adjacent side wall of the vehicle body,

(k) spaced latch bolts slidably mounted in the edges of the said partition

(l) rods having handles thereon pivotally mounted in the partition,

(m) means connecting the said latch bolts to the rods whereby the latch bolts may be withdrawn

(n) from locking engagement with the side walls of the vehicle body by the rods,

(o) and means resiliently urging the said latch bolts into locking engagement with the side walls for retaining the partition in a transverse position in the vehicle body.

It is well established law that the claims measure the patent monopoly and the patent is infringed only if every element of the claim, or its functional equivalent, is found in the accused article.

In *Nelson v. Batson* (C.A. 9, 1963), 322 F. 2d 132, this Court held that the claims measured the patent

monopoly and provide the standard against which infringement is determined, stating at page 134:

> "* * * The claims measure the patent monopoly, and their language provides the standard against which infringement is initially to be determined. * * * the patent is infringed only if all of the elements set forth in the claim are found in the accused device." (Authorities cited).

To the same effect is the decision of this Court in *Lockwood v. Langendorf United Bakeries, Inc.*, 324 F. 2d 82, in which the Court held at page 88:

> " 'In a combination patent, such as involved in this case, every element of a particular claim is presumably essential and, therefore, every element of the claim, or its functional equivalent, must ordinarily be found in the accused article. See: Q-Tips, Inc. v. Johnson & Johnson, 207 F.2d 509 (3rd Cir. 1953).
>
> " 'Where, as in this case, no embodiments of the patent asserted by plaintiff have ever been produced for commercial use, that circumstance is one calling for a narrow rather than a liberal construction of its claims. See: Thompson v. Westinghouse Elec. & Mfg. Co., 116 F.2d 422, 425 (2d Cir. 1940); Glendenning v. Mack, 159 F.Supp. 655, 668-669 (D. Minn. 1958).' "

Differences in Structure and Mode of Operation. Findings 28, 29 and 40.

Findings 28, 29 and 40 are supported by substantial evidence. For example, Beemer testified that a device of the patent in suit would not be at all suitable for

use in a railroad car and gave his reasons in support of that statement [Tr. 393-397]. He further testified that the Preco structures operate in an entirely different manner than the Wells device.

There is a great dispute in the testimony as to how the loads are carried in the Wells structure and in the Preco load dividers. Evans witness Nickerson had considerable difficulty in testifying in that respect [Tr. 585, 778-790, 1270-1272, 1276-1279]. Professor McCormick, an expert in analysis and design of structures, testified that in Wells the loads and stresses are carried on the beam 42 and the stub ends 44, and that in Preco Model BD-2 the bulkhead is supported by the timing shaft 44, which in turn is supported by the rollers. He testified that the Preco load bearing structure was different from that of Wells [Tr. 1131-1144].

Mr. Erickson, the Chief Engineer of Preco, testified from fact that the squaring bar performs a load bearing function, that it is the only member that is engaged on the tracks [Tr. 1282-1296]. Beemer testified that in the BD-2 model load divider that the load of the timing or squaring shaft is carried by the smooth cylindrical roller beyond the sprocket element [Tr. 441-442].

As has been shown in the section entitled "The Admissions against Interest in the File Wrapper of the Erickson, Moorhead, et al. Application, Exhibit 59, and the Admissions of Evans' Witness Moorhead", the admissions in Exhibit 59, and the corroborating testimony of Moorhead alone constitutes substantial evidence to support Findings 28, 29 and 40.

The Wells patentees had no idea of how they would mount their device in a freight car. In the file wrapper

they objected to Jones patent No. 1,803,760, as a reference, stating:

> "* * * The Jones construction would not function for the applicant's purpose, since there are no overhead members 13 in a truck, as in Jones, to which to secure a rail. Expensive alterations and reconstruction would be necessary.
>
> * * * * *
>
> "Such reconstruction would be only in the light of the applicant's disclosure and would be unfair.
>
> "Neither Laffey nor Jones could function for the applicant's purpose in a truck." [Ex. 1, p. 27].

In Finding 28 the Court found that the Preco load dividers are so different from Wells that it is like comparing "apples and oranges".

Mr. Chesnut testified that the Preco structures were entirely different from Wells. As an example, see Transcript 1229.

In *Engelhard Industries, Inc. v. Research Instrumental Corp.* (C.A. 9, 1963), 324 F. 2d 347, this Court held at page 351:

> "* * * a patent for an apparatus is not infringed unless the accused device is a copy of the claimed apparatus 'either without variation, or with such variations as are consistent with its being in substance the same thing.' Sanitary Refrigerator Co. v. Winters, 280 U.S. 30, 42, 50 S.Ct. 9, 13, 74 L.Ed. 147 (1929), quoting from, Burr v. Duryee, 1 Wall. 531, 573, 68 U.S. 531; 573, 17 L.Ed. 650 (1863)."

In Finding 29 [R. 395], the Court found that the Preco accused devices are different "* * * The elements are different, the coaction between the elements are different, and the structures have a different mode of operation from the load divider disclosed in the patent in suit."

Please note three of the important differences in Preco's BD-6 model load divider which were demonstrated and pointed out to the Trial Court during the inspection of the freight car having Model BD-6 on November 2, 1966 [Tr. 123-127] (p. 27, *supra*).

The structure shown in the Wells patent in suit has a cross-bar which slides and does not rotate and in which the guiding action is performed by vertical flanges of the C-shaped rails operating in conjunction with the rollers on the ends of the bars. Preco's rotating cross-bar with its integral sprockets which does not slide but which rotates, is a different element from any employed by Wells. The aligning action in Preco results from the "geared" action of two sprockets tied together by the cross-bar, forming an integral unit which rotates as a unit. This mechanism has a mode of operation different from that of Wells, therefore, there can be no infringement. The Trial Court, considering the facts as to how the two structures operated, made the Finding that Preco has a different mode of operation.

The locking mechanism of Preco is different from that of Wells because it cooperates between the partition and the floor and between the partition and the top rail. It has a different construction and mode of operation enabling a single locking mechanism to be used for locking the partition either in a transverse po-

sition or in a stored position folded against the side wall of the freight car.

Furthermore, there is the following different mode of operation:

In Wells the locking bars are horizontal and project into openings in the side wall of the freight car. This is an undesirable feature which the Court found resulted in Wells being unsuited for freight car use [Finding of Fact 26, R. 394].

In Preco the partition is supported on the rails only when the partition is being moved from one longitudinal position to another longitudinal position in the freight car. When the partition is supported in a transverse position or in a folded position against the side walls of the freight car the latch means functions to raise the partition and relieve the longitudinal tracks and supporting swivel of its weight and to cause the partition to be supported by the floor of the freight car.

Thus, we have another difference in mode of operation supported by facts and by law which we have as a ground of non-infringement.

Wells shows but a single device and their description is limited to that single device. There is no substance which would establish that their ideas were any broader. The claims of the patent in suit are not infringed because the claims must be limited to the device disclosed in the patent in suit under the doctrine of *McRoskey v. Braun Mattress Co.* (C.A. 9, 1939), 107 F. 2d 143, in which the Court said at page 146:

> "Whether the mattress depressing members of the frames described in the claims are conical-

> shaped or not, the claims do not state, but, since conical-shaped mattress depressing members are the only ones mentioned in the specification, it must be assumed that the mattress depressing members of the frames described in the claims are likewise conical-shaped. For the claims must be read in the light of the specification. Henry v. Los Angeles 9 Cir., 255 F. 769, 780."

An examination of Preco's structures show that Preco followed the prior art. The accused structures do not infringe the patent in suit because the structures followed disclosures in the prior art and not the patent in suit.

Preco uses the rotating support bar with integral gears such as is shown in the patent to Moriarty No. 1,388,819, Exhibit 2-D, and functions as taught by Moriarty, Exhibit 2-D or Harris No. 1,825,452, Exhibit 2-J, and Laffey, No. 1,522,784, Exhibit 2-E. Preco's means for supporting the partition from the crossbar is plainly shown in Deady Patent No. 1,622,574, Exhibit 2-G, as well as numerous other patents relied on by Preco.

Preco's locking of the partition by vertically extending and vertically movable bolts is shown in the patents to Moriarty, Exhibit 2-D, Dixon, Exhibit 2-N and Angell, Exhibit 2-K.

Therefore, under well-established law of this Circuit, there can be no infringement. In *Air Devices, Inc. v. Air Factor* (C.A. 9, 1954), 210 F. 2d 481 at page 483, this Court held there was no infringement where the results obtained were not secured by the same means or by a device operated in the same manner.

"* * * Identity of result is no test. Stebler v. Porterville Citrus Ass'n, 9 Cir., 248 F. 927. As the results obtained are not secured by the same means, or by a device operated in the same manner, or in substantially the same manner, the several devices are not equivalents. Leishman v. Associated Wholesale Electric Co., 9 Cir., 137 F.2d 722, 727."

The Union Paper Bag Case, 97 U.S. 121, 125;

69 Corpus Juris Secundum 861, Section 292;

Walker on Patents, Deller's Edition, Volume 3, Section 496, page 1750;

Graver Tank & Mfg. Co., Inc., et al. v. Linde Air Products Co., 339 U.S. 605, 608, 609, 94 L.Ed. 1097;

Grant v. Koppl, 99 F. 2d 106 (C.A. 9), wherein the Court said at page 110:

"We note that appellant contends that the claims of the patent in suit read upon appellees' device. We may assume that this is true, especially as to claim 9. But infringement is not a mere matter of words. (Authorities cited) Here, we hold that the mode of operation is different and that there is no equivalency of means. It is not necessary to discuss the claims separately or in detail. * * *"

File Wrapper Estoppel.

Finding 41.

As found by the Trial Court, there is file wrapper estoppel which prevents infringement of claim 1, and this, although it requires an interpretation of language of documents, is, nevertheless, factual in so far as what occurred before the Patent Office.

Claim 1, as originally filed, was claim 1 of the application and was written as shown on page 10 of the File Wrapper Contents, Exhibit 1. This claim, as originally written, was broad enough to cover any type of movable cross-bar. The claim was rejected by the Examiner (File Wrapper Contents, page 15), and it was thereafter amended (File Wrapper Contents, page 25) to cancel the word "movable" and substitute—slidably mounted on said rails for movement—, and to add the words—said rails being constructed for guiding such movement—.

Claim 1 originally read: "* * * a bar disposed between and supported by said rails, the ends of said bar being movable to selected positions with respect to the longitudinal length of said rails, * * *". As amended, this portion of the claim now reads: "* * * a bar disposed between and supported by said rails, the ends of said bar *being slidably mounted on said rails for movement* to selected positions with respect to the longitudinal length of said rails, *said rails being constructed for guiding such movement,* * * *"

This limitation limits claim 1 to an arrangement in which the bar slides in its movement along the rails and in which the rails are constructed for guiding such movement. A sliding movement is a movement in which there is no rotation. The bar as defined in claim 1 slides and does *not* rotate.

Preco's accused structures have a cross-bar with sprockets secured to each end providing an integral assembly which rotates *as a unit* when the bar is moved along the rails. This bar does not slide, that is, move without rotation, as now specified in the claim, as amended.

Also, the claim is now limited by the words "said rails being constructed for guiding such movement" to an arrangement in which the rails being C-shaped have the side walls which are engageable by the rollers on the ends of the cross-bar to guide the ends of the bar.

There is also considerable difference in the testimony with respect to whether or not the ends of the squaring bars in the Preco load dividers are "slidably" mounted on the rails for movement.

The testimony of Nickerson [Tr. 606-622] and Moorhead [Tr. 979-980] is in dispute with that of Chesnut [Tr. 1103, 1104, 1151] and Beemer [Tr. 337-342].

Mr. Chesnut's testimony with respect to file wrapper estoppel is on Transcript 1146 to 1151. Mr. Nickerson's testimony is on Transcript 751-752.

The Trial Court found in Finding 41:

> "* * * By virtue of the amendment to claim 1, the claim was limited by the principle of file wrapper estoppel to a structure in which the transverse bar is slidable and cannot be construed to cover a transverse rotable bar having sprockets secured to the ends thereof and which is rotatable." [R. 398-399].

Preco contends that the claims are not infringed under the doctrine of *Exhibit Supply Co. v. Ace Patents Corporation,* 315 U.S. 126, 136, 137, which states:

> "* * * By striking that phrase from the claim and substituting for it 'embedded in the table,' the applicant restricted his claim to those combinations in which the conductor means, though carried on

the table, is also embedded in it. By the amendment, he recognized and emphasized the difference between the two phrases and proclaimed his abandonment of all that is embraced in that difference. (Authorities cited). The difference which he thus disclaimed must be regarded as material, and since the amendment operates as a disclaimer of that difference it must be strictly construed against him. (Authorities cited) As the question is one of construction of the claim, it is immaterial whether the examiner was right or wrong in rejecting the claim as filed. (Authorities cited) * * *"

Also see:

Moon v. Cabot Shops, Inc. (C.A. 9, 1959), 270 F. 2d 539, 549;

Oregon Saw Chain Corporation v. McCulloch Motors Corporation (C.A. 9, 1963), 323 F. 2d 758, 768.

Conclusion.

The Judgment of the Trial Court holding the patent invalid and not infringed was plainly correct and should be affirmed by this Court.

Respectfully submitted,

R. Welton Whann,
Robert M. McManigal,
Attorneys for Appellee.

Dated: November 4, 1966

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

Robert M. McManigal

No. 20,868

IN THE

United States Court of Appeals for the Ninth Circuit

EVANS PRODUCTS COMPANY,
Defendant-Appellant,

vs.

PRECO INCORPORATED,
Plaintiff-Appellee.

APPELLANT'S REPLY BRIEF

HARNESS DICKEY & PIERCE,
By JOHN A. BLAIR,
ROBERT L. BOYNTON,
700 Fisher Building,
Detroit, Michigan 48202;

LYON & LYON,
By ROLAND N. SMOOT,
811 West Seventh Street,
Los Angeles, California 90017,
Attorneys for Defendant-Appellant.

Interstate Brief & Record Co., 356 Congress St. E., Detroit, Michigan 48226

TABLE OF CONTENTS

		Page
I.	Errors in Preco's Brief	1
II.	Re Rule 52(a) of the Federal Rules of Civil Procedure	3
III.	Infringement	3
	A. The Contention that the "Findings of Fact" on Infringement are Not Shown to be Clearly Erroneous	3
	B. The Alleged Admissions of Evans Are Irrelevant to the Question of Infringement	10
	C. The Three Important Differences Relied Upon by Preco	13
	D. The Contention of File Wrapper Estoppel	13
	E. The Contention That the Wells Claims Should be Limited to the Device Disclosed	14
	F. The Contention that Preco Followed the Prior Art	15
IV.	Validity	16
	A. The Contention That the "Findings of Invalidity" Are Not Clearly Erroneous	17
	B. The Contention that the Structure of the Wells Patent in Suit Has Never Been Produced and Is Not Suitable for Use In a Freight Car	19
Conclusion		20

TABLE OF AUTHORITIES CITED

Page

Bergman v. Aluminum Lock Shingle Corp. of America, 251 F. 2d 801 18
Canadian Ingersoll-Rand Co. v. Peterson Products, 350 F. 2d 18 12
Continental Connector Corp. v. Houston Fearless Corp., 350 F. 2d 183 18
Exhibit Supply Co. v. Ace Patents Corp., 315 U.S. 126 14
Graham v. John Deere Company, 383 U.S. 1, 15 L. Ed. 2d 545 17
Kemart Corp. v. Printing Arts Research Lab. Inc., 201 F. 2d 624 9
Kwikset Locks Inc. v. Hillgren, 210 F. 2d 483 8
Mahn v. Harwood, 112 U.S. 354 18
McRoskey v. Braun Mattress Co., 107 F. 2d 143 .... 9, 14
Moist Cold Refrigerator Co. v. Lou Johnson Co., 249 F. 2d 246 16
Stuart Oxygen Co. v. Josephian, 162 F. 2d 857 9

IN THE

United States Court of Appeals for the Ninth Circuit

No. 20,868

EVANS PRODUCTS COMPANY,
Defendant-Appellant,

vs.

PRECO INCORPORATED,
Plaintiff-Appellee.

APPELLANT'S REPLY BRIEF

I. ERRORS IN PRECO'S BRIEF

Before dealing with both the arguments presented in and the arguments omitted from the brief of Appellee Preco, it may be well to correct the following incorrect representations appearing in Preco's brief:

1. The trial court did not require both parties to submit proposed findings of fact and conclusions of law, as stated on page 3 of Preco's brief, nor did Evans file any proposed findings and conclusions as there stated. After delivering an oral opinion at the end of the trial the District

Court directed that Preco submit findings and conclusions in conformity with the opinion. While the trial court indicated that Evans could propose findings on any issues *not covered in the Court's oral opinion* and could object to the proposed findings on the issues which had been covered (TR. 1388) there was no requirement that Evans file proposed findings. While Evans did present to the trial court objections to the Findings of Fact and Conclusions of Law proposed by Preco, it did not submit any proposed findings or conclusions to the trial court.

2. Three numbered and allegedly important differences between the patent in suit and the accused devices are set out at pages 27 and 28 of Preco's brief. In the difference numbered (2) it is stated that the rails are mounted on the ceiling rather than the wall. The statements at pages 28 and 59 of Preco's brief that these important differences in Preco's BD-6 model load divider were demonstrated and pointed out to the trial court is clearly erroneous since the rail in the Model BD-6 is admittedly mounted on the wall. See page 32 of Preco's brief.

3. Preco states at page 44 of its brief that Evans did not contend before the trial court that the Potter Patent No. 226,702 relied upon by Preco and covering a farm gate, is from a non-analogous art. This is absolutely false. Evans did so contend both during the taking of the testimony (TR. 1092), and during the final argument (TR. 1379).

II. RE RULE 52(a) OF THE FEDERAL RULES OF CIVIL PROCEDURE

Without specifically citing this rule Preco states, page 9, that factual findings are not to be disturbed unless clearly erroneous and thereafter in its brief seeks to characterize virtually all of the determinations of the trial court which it discusses, as factual findings. The errors of the trial court will be considered in detail herein as they apply to each of the issues discussed, but it may be said at the outset that the so-called Findings of Fact of the trial court which are here in dispute, in most cases are in reality erroneous legal conclusions or are based on errors of law and accordingly, are not entitled to the benefit of Rule 52(a) and are determinations which should properly be made by this Court unfettered by any application of Rule 52(a). In the few instances where the determinations of the trial court here in issue are properly considered to be findings of fact, it will be seen that they are cleary erroneous.

III. INFRINGEMENT

A. The Contention that the "Findings of Fact" on Infringement are Not Shown to be Clearly Erroneous

Preco contends at page 52 of its brief that the "Findings of Fact" dealing with the question of infringement are supported by evidence and that Evans has failed to show that they are "clearly erroneous" as required by Rule 52(a). However, if the so-called "evidence" in support of these findings is examined, it will be found to boil down to testimony of Preco's expert witness, Chestnut, based solely on a gross misconstruction and misapplication of the patent

claims. There is no material dispute as to how the accused bulkhead systems are constructed or how they operate and there is no dispute as to the construction or function of the bulkhead system disclosed in the Wells patent. Moreover, Preco has offered no evidence tending to refute the obvious fact that the elements of the accused construction are substantially the same as and perform the same function and co-act with each other in the same manner as the corresponding elements of the new combination claimed in the patent.

The alleged conflict in the evidence as to the readability of the claims on the accused constructions resides solely in the denial by Mr. Chestnut that the claim language properly describes the accused constructions, which denial he highlighted by writing the word "No" after most of the entries on charts which were attached to the Evans trial brief and, which were thereafter offered in evidence as DX AZ-1, 2 and 3 to illustrate the respective positions of the parties on the question of readability.* However, as pointed out in the Appellant's Brief on this appeal at pages 29-41, these statements by Mr. Chestnut are mere conclusions based on a clearly erroneous assumption or upon a clearly erroneous construction of the patent claims. The District Court in accepting and following these conclusions made errors of law. Moreover, if the conclusions involve any findings or inferences of fact they are clearly erroneous and not supported by the evidence.

The errors fall into two main categories, discussed below:

1. The District Court adopted a gross misapplication of three clauses of Claim 1 to the accused construction. The three clauses in question are those designated (g), (j) and (k) on the chart DX AZ-1. There is a pretension that this involves a finding on a factual issue, but this will not stand

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* Copies of these charts appear as part of the Appendix to the main brief for Evans.

the test of close examination. If clause (g), which reads as follows:

> "a bar disposed between and supported by said rails, the ends of said bar being slidably mounted on said rails for movement to selected positions with respect to the longitudinal length of said rails"

is applied to the transverse bar numbered 42 on the stipulated charts DX AE-1* and DX AF* showing the accused Model BD-2, *to which it is fully and fairly applicable,* then there would remain no basis for denying that clauses (j) and (k) are also fully applicable to the accused Model BD-2. Thus, clause (j) calls for "a pivotal connection between said member (the bulkhead 40) and the said bar" 42, which is the pivotal connection between the supporting yoke 56 and the pin 52 best shown in the chart DX AF. Similarly, clause (k) calls for "means slidably mounting the said pivotal connection on the bar . . .", which is the roller bracket 54 with its supporting rollers 62 which move along the length of the bar 42.

The Preco expert Chestnut supported his denial that these three clauses are applicable to the accused construction BD-2 by taking the position that the term "bar" of clause (g) had to be applied to the timing shaft rather than the bar 42. From this false premise he then asserted that clause (j) was not applicable because in the accused constructions the "pivotal connection" was not between the bulkhead and the timing shaft. But it should be noted he did not deny that in the accused constructions there was "a pivotal connection between said members (the bulkhead) and said bar" 42 which functioned in exactly the same manner as the pivotal connection of the patent. That there is such a connection between the bulkhead and the bar 42 is obvious and cannot be denied. Consequently, there is no

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* Copies of these charts appear as part of the Appendix to the main brief for Evans.

support for his denial as to clause (j) *if* the "bar" of clause (g) is the transverse bar.

Chestnut also asserted that clause (k) was not applicable because in the accused constructions there was no "means slidably mounting the said pivotal connection on the bar . . .", considering the "bar" to be the timing shaft. But again, note he did not deny that the accused constructions included "means slidably mounting the said pivotal connection on the bar" 42. Here also, that there is such a means slidably mounting the pivotal connection on the bar 42 is obvious and cannot be denied. Thus, there is no support for his denial as to clause (k) *if* the "bar" of clause (g) is the transverse bar 42.

That clause (g) is properly applicable to the bar 42 of the accused constructions is pointed out in Evans' main brief on this appeal at pages 29 to 31. The utter fallacy of Chestnut's application of the term "bar" of clause (g) to the timing shaft of the accused constructions is evident from the fact that Chestnut himself testified that the timing shaft of the accused BD-2 model did not have the characteristics attributed to the "bar" in clause (g) itself (TR. 1103-4). In fact, this is the very basis on which he applied the word "No" to the entries in the horizontal line opposite clause (g) on the chart DX AZ-1, and opposite the corresponding clauses (e) of Claims 2 and 3 on charts DX AZ-2 and 3. Thus, we have a house of cards built by Chestnut on a foundation which his own testimony destroys. Evans' position here with respect to clauses (j) and (k) is clearly borne out by the fact that in the case of the accused Model BC-4 where Preco admits that the transverse bar 42 satisfies clause (g) it similarly admits that clauses (j) and (k) are satisfied. See the absence of "Noes" on DX AZ-1 in the model BC-4 column opposite the clauses (g), (j) and (k).

If the District Court's wholesale adoption of Chestnut's theory of claim application can be considered a finding of fact, it is clearly erroneous. It is noted that Preco did not make any attempt in its brief to present any justification for or any defense of this gross misappplication of the language of the claims of the Wells patent in suit which was referred to in Appellant Evans' main brief at pages 3, 20 and 23, and which was set out in detail at pages 29 to 31 , 37 and 39. Preco offered no excuse for this calculated effort to make the claim not read on the accused devices by intentionally selecting as the member upon which the claim language ''transverse bar" should read, a member through which the transverse bar in the accused devices is supported on the rails.

In assessing the positions of the two parties here with respect to scope of the claims, it is worthy of note that Evans adopted and persisted in its construction even though under the agreement covering its purchase of the Wells patent this required it to pay royalties under the patent in suit on its DF-B bulkhead equipment and it has, accordingly, paid over $100,000 of such royalties (TR. 986-7). On the other hand, Preco adopted its strained construction as a device to escape liability for infringement.

2. The District Court has read into the patent claims limitations which are not expressed therein and which are not required to distinguish over the prior art or to limit the claim to equivalents of the claimed combination. This is an error of law. While it is occasionally proper to limit a claim by reading into it an unexpressed limitation in order to save its validity, that practice is not warranted when, as here, the unexpressed limitation in question does not distinguish over the prior art or impart patentability. Not even Preco suggest that the limitations it urges are required for this purpose.

It may also be proper to so limit a claim that it will encompass only equivalents of the structure disclosed in the patent, but this negative application of the doctrine of equilavents has no application here because no evidence was offered tending to show that the claimed elements of the patented combination were substantially different or functioned in any different manner or produced any different result than the corresponding elements of the accused construction as set forth in the typed material on the claim charts DX AZ-1, 2 and 3.

The claim language which the court below was lead to restrict beyond the letter and spirit of the language itself is found in clauses (d), (e), (f), (h) and (l) of Claim 1. The obvious errors of law and fact involved in the District Court's ruling that these clauses must be construed to distinguish over the accused constructions are discussed in the main brief for Evans (Appellant's Brief) at pages 31 to 37. Similar errors as to Claims 2 and 3 are discussed at pages 37-41, and the authorities which support the conclusion that there are errors of law are set forth at pages 41-42.

Even the authorities cited by Preco recognize that in cases such as the present one the question of infringement resolves itself into one of law. In *Kwikset Locks Inc. v. Hillgren,* 210 F. 2d 483, this Court stated, pp. 488-9,

> "While it is true that a district court's finding of infringement is generally considered to be a finding of fact that may not be set aside unless clearly erroneous, 'it is (also) well settled that where, as here, there is no dispute as to the evidentiary facts, and the record and exhibits enable us to clearly comprehend the nature both of the process patented and the alleged infringement process, the question of infringement resolves itself into one of law, depending upon a comparison between the two pro-

> cesses and the correct application thereto of the rule of equivalency. The testimony in this case was largely expository and descriptive of the elements and operation of the two processes and was not disputed.' "

The Court cited its prior decision in *Kemart Corp. v. Printing Arts Research Lab, Inc.*, 201 F. 2d 624, also cited in Preco's brief, where this Court used substantially the same above quoted language at pp. 627-8.

Also, in *Stuart Oxygen Co. v. Josephian*, 162 F. 2d 857, in a case where the testimony involved the proper meaning of claim language, this Court rejected the contention that Rule 52(a) was applicable to the lower court's determination on the issue of infringement and stated, page 859,

> "The terms of the patent and the respective devices of the parties are also before us for our inspection. The facts are clear and undisputed and the question of infringement in this case can be determined by a comparison of structures and is a question of law."

The mere fact that Chestnut testified that the claims do not read upon the accused devices does not make the acceptance of that conclusion a finding of fact. In *McRoskey v. Braun Mattress Co.*, 107 F. 2d 143, also cited by Preco, this Court affirmed the action of the lower court, in a jury case, in directing a verdict of no infringement in spite of expert testimony that the claim read on the accused device.

B. The Alleged Admissions of Evans Are Irrelevant to the Question of Infringement

In an apparent attempt to make it appear that the lower court's holding of no infringement is supported by evidence, Preco in its brief repeatedly refers to so-called admissions by Evans that the accused structures differ in a number of respects from the embodiment of the Wells invention which is illustrated and described in the patent in suit. The District Court also seemed to attach great significance to these so-called admissions. There is no dispute over the facts of this matter. These structures *do* differ in a number of respects and neither Evans nor any of its witnesses has ever pretended otherwise. The Evans commercial construction, since it is essentially the same as several of the accused constructions, similarly differs from the structure illustrated in the patent. *However, these differences have no bearing whatever upon the question of infringement.*

In the first place, as has been shown, none of these differences impairs the readability of the claim language on the accused constructions. Each phrase of each claim is fully and fairly applicable to every one of the accused constructions except that model BC-3 employs a mere reversal of parts from that recited in clauses (e) and (i) of claims 2 and 3 all as pointed out in detail in the claim charts DX AZ-1, 2 and 3. The claim language is not only fully applicable but it means the same thing when read upon the accused constructions as it does when read upon the illustrative embodiment in the patent.

Secondly, *there is no evidence* which indicates that the basic elements of the accused constructions function differently or co-act with each other in any different way

than the corresponding elements of the patent. The differences, in short, are of two kinds. First, those obvious modifications required to adapt the invention to a freight car—an adaptation expressly contemplated by the patent itself; and second, mere additions to the patented combination which provide added functions without altering the operation or function of the basic elements set forth in the patent claims.

The differences which any mechanic would recognize were necessary to adapt the bulkhead system to railroad use cannot support a finding of non-infringement when they do not involve any departure from the basic principles of construction and operation taught by Wells. In this instance, the inventors chose to illustrate an embodiment of their invention suitable for use in an open top cattle truck. Under the patent law they were under no obligation to illustrate embodiments suitable for use in other environments where no unobvious alterations were required, but they did expressly state that the invention could be used in freight cars. It is obvious that for that purpose a larger and stronger piece of equipment would be required.

The idea of using bulkheads in freight cars was not a new one at the date of the Wells invention. Many bulkhead designs had been tried and many more patented. The features of these prior constructions were available for use in adapting the Wells invention to freight car use. Thus, for example, it was recognized that the bulkhead had to be secured as by sliding bolts to the side walls or other fixed parts of the car to hold the bulkhead in place and sustain the heavy shock loads. In prior art patents, such bolts are disclosed, some operating horizontally and some operating vertically. The essential structure, function and result is the same, whether the bolts move horizontally or vertically. The claims of the patent in suit do not

specify in what direction the lock bolts move and, therefore, infringement cannot be avoided by providing vertically moving bolts.

Considerable stress is laid by Preco on the fact that its vertically moving lock bolts at the lower edge of the bulkhead have shoulders which rest on the lower locking strips and sustain part of the weight of the bulkhead, thereby relieving the supporting transverse bar 42 of shock loads due to vertical vibration. This function of protecting the suspension from shock loads due to vertical vibration is also performed by the horizontal bolts of the patent (TR. 558-9, 811-12). Surely, one cannot escape infringement by claiming that the assumed construction performs a function performed by the patented construction. In any event, this feature, including the sustaining of part of the weight on the vertical pins, is a refinement which is not called for by the patent claims and its presence in the accused devices in no way negatives infringement.

Finally, the statements regarding these differences to which Preco points in the Erickson et al. application for patent relating to the Evans commercial DF-B bulkhead were not statements construing the scope of the Wells patent in suit. Accordingly, the case of *Canadian Ingersoll-Rand Co. v. Peterson Products,* 350 F. 2d 18, relied upon by Preco, clearly does not support the relevance of the statements from the Erickson et al. application for in that case the statements in question were made in construing the scope of the patent in suit. The statements to which Preco points in the present case were made in arguing the patentability of certain improvements not involved in the present case and in no way related to the *scope* of the Wells patent in suit. The proper case law regarding the irrelevancy of such statements is pointed out at page 45 of Appellant's

main brief and is not contra to this Court's decision in the *Canadian Ingersoll-Rand* case, *supra,* as stated by Preco at page 41 of its brief.

C. The Three Important Differences Relied Upon by Preco

None of these allegedly important differences (Preco brief pages 27-30 and 59-60) presents any factual dispute, the sole dispute being as to the legal effect of these differences and the proper construction of the claims of the patent in suit. As pointed out in Evans' main brief, pages 41 to 44, when the claims in suit are correctly construed, these differences in no way support the holding of no infringement. The principles there stated are applicable to each of these claimed improvements, whether it be the use of the timing shaft to provide an aligning action in the accused devices, or the carrying of the rails and detents on the side walls through the ceiling structure (to permit its assembly therewith as a unit) as in most of the accused models as opposed to the Model BD-6 where the rails and detents are carried directly on the side walls, or the use of the vertically moving lock bolts discussed in the previous section. In all of the accused devices the basic combination of the patent in suit is employed and the incorporation of these differences in no way avoids infringement.

D. The Contention of File Wrapper Estoppel

Finding No. 41 is clearly a conclusion of law based on undisputed facts. Preco states that it is factual insofar as what occurred before the Patent Office, but there is no dispute of fact regarding what occurred before the Patent Office. The issue of file wrapper estoppel presents a ques-

tion of claim construction as stated by the Supreme Court in *Exhibit Supply Co. v. Ace Patents Corp.*, 315 U.S. 126, 137 and is thus clearly an issue of law for the Court.

Appellant's position regarding the language "slidably mounted on said rails" is fully set out in its main brief at pages 46 and 47.

Preco seeks at page 64 to suggest that there is a file wrapper estoppel limiting Claim 1 to an arrangement in which the rails are C-shaped. There is nothing in the file wrapper in any way warranting this contention. The construction of the claim language "said rails being constructed for guiding such movement" is a question of law for the Court. This language appears in clause (h) of Claim 1 which is dealt with at pages 34 to 37 of Appellant's main brief from which it will be seen that this language properly reads on the accused devices.

E. The Contention That the Wells Claims Should be Limited to the Device Disclosed

This contention is contrary to the decisions of the Supreme Court and of this Court referred to at pages 36 and 37 of Evans' main brief when, as in the present case, such limitation is not required either by the claim language or to avoid the prior art. In the only case relied upon by Preco in support of this contention, namely, *McRoskey v. Braun Mattress Co.*, 197 F. 2d 143, this Court had before it a fact situation in which the only distinguishing feature was the conical shaped mattress depressing members which designate the places where the mattress was to be tufted, as stated at page 145, and thus the prior art there required the limited construction adopted by the Court.

F. The Contention that Preco Followed the Prior Art

An examination of this contention shows that Preco's following of the prior art is with reference to its so-called improvements incorporated in its embodiments of the Wells et al. invention which it builds for use in railroad cars. It is not stated that it is following any prior art as to the basic combination of the Wells patent in suit. On page 61 of Preco's brief where this contention is presented, it is argued that Preco uses the timing shaft of Moriarty and vertically moving lock bolts as shown in several prior art patents. While these differences may render the Preco accused devices more suitable for railroad car use than the truck embodiment illustrated in Wells, they in no way show that Preco was following the prior art insofar as the basic combination of the Wells patent in suit is concerned. The statement that Preco is using the means for supporting the partition from the crossbar shown in Deady No. 1,622,574, provides no proper support for this contention that Preco followed the prior art. Deady does not show any partition and in fact, relates to the travelling beam crane art which as pointed out in Evans' main brief, page 61, is a non-analogous art.

None of the prior art shows or suggests the basic combination of the patent in suit, namely, a bulkhead mounted on a transverse bar for pivotal movement relative thereto between a position in which the bulkhead extends transversely of the car and a position in which it extends longitudinally of the car and in which the bulkhead may be moved transversely of the car by moving it along the transverse bar and in which the bulkhead may be moved longitudinally of the car by moving the transverse bar along longitudinally extending rails upon which it is supported, together with

means for locking the bulkhead in position transversely of the car. This basic combination in which the elements function and coact to provide the universal adjustability pointed out at pages 8, 60, 65 and 66 of Evans main brief, is taught only in the patent in suit and it is the patent in suit, not any prior art, which Preco is following in employing this basic combination.

IV. VALIDITY

This issue is fully treated in Evans' main brief at pages 51 to 67. Attention is directed to the fact that Preco in its brief does not deny that there was a long-felt need for an improved bulkhead for bracing freight in freight cars, nor does it deny that when Evans brought out its DF-B bulkhead equipment it met with an immediate and remarkable commercial success. Neither does it deny that Preco abandoned its own prior designs dating back as early as 1940 and adopted the bulkhead constructions accused herein. Preco says, page 25, that it ceased manufacture of its early designs because of World War II but admits that it did not restart bulkhead manufacture until thirteen years after the war was over and after it claims, page 19, that Evans had made its first DF-B (Wells type) bulkhead. Its only answer to the commercial success so clearly shown in this case is that by intentionally applying the claim language to the wrong elements, resulting in misapplication and misconstruction of the claims, it has shown that the claims in suit do not cover the commercially successful bulkheads. This ruse having been exposed, the commercial success stands established. As pointed out at pages 52-53 of Evans' main brief, the entire industry has adopted the basic combination of the patent in suit. The following statement of this Court in *Moist Cold Refrigerator Co. v. Lou Johnson Co.*, 249 F. 2d 246, 253-4, a case cited by Preco, is believed to be applicable here,

"Once it has been established that a mechanical problem has been recognized as a problem within an industry for a long time, and that men of ordinary skill in the art have failed to meet it, there is at least some ground for the conclusion it was beyond their capacity, and 'such a circumstance has not infrequently been held sufficient to carry a discovery across the inventive line.' (citing cases).

"The significance of proof, both of lack of prior discovery, and of public acceptance thereafter, is that this is some evidence that the inventor has done something in his combination which, even though obvious now, was not then obvious to those skilled in the art."

Attention is also directed to the fact that Preco in its brief does not deny the fact, pointed out in Evans' brief at page 58, that the District Court made no finding and entered no conclusion of law that the patent in suit does not meet the statutory requirement of novelty.

A. The Contention That the "Findings of Invalidity" Are Not Clearly Erroneous

An examination of the so-called "findings of invalidity" in view of the Supreme Court decision in *Graham v. John Deere Company,* 383 U.S. 1, 15 L. Ed. 2d 545 and the pertinent decisions of this Court reveals as pointed out in Evans' main brief, pages 58 to 60, that they involve only legal conclusions based on undisputed facts. This is even apparent from Preco's analysis appearing at pages 13 and 14 of its brief. With respect to the "first factual determination" referred to in the Graham case, Preco makes no claim that there is any factual dispute as to the scope and content of prior art. Similarly, with respect to the second matter, Preco makes no claim that there is any factual

dispute as to the differences between the claims of the patent in suit and the prior art. The third and last factual consideration stated in Graham is the level of ordinary skill in the art to which the invention pertains. Preco contends, page 14, that this determination is to be made from all of the prior art, which in this case is not in dispute. Moreover, the District Court made no determination of the level of ordinary skill in the art to which the invention pertains, and therefore, it is only its ultimate legal conclusion of obviousness in view of the undisputed facts, which is disputed here. Rule 52(a), of course, does not apply to this legal conclusion, as is conceded by Preco.

This is also recognized by the decisions of this Court cited by Preco. See *Bergman v. Aluminum Lock Shingle Corp. of America,* 251 F. 2d 801, 803 where this Court quoted from the Supreme Court decision in the A & P case the statement that the question of validity of a patent is a question of law. It also quoted from *Mahn v. Harwood,* 112 U.S. 354 the statement that whether the thing patented amounts to a patentable invention is a question of law. Also, in *Continental Connector Corp. v. Houston Fearless Corp.,* 350 F. 2d 183, much cited by Preco, this Court stated the same principle with reference to a combination patent, stating that the result there reached is not based on any belief that this Court is bound by the conclusion of the trier of fact as to validity, adding that validity of a combination patent is determined as a matter of law.

Preco's suggestion at page 14 of its brief, that there are no differences between what is claimed in the patent in suit and the prior art, misrepresents the matter in two respects. Firstly, the suggestion that all of the elements of Wells are generally old does not support the representation that there are no differences from the prior art where, as here, the patent in suit is for a new combination which

meets the statutory test of novelty, which is not suggested in any of the prior art, which accomplishes a new and useful result, which filled a long-felt need, and which has had a remarkable commercial success, all of which indicates the unobviousness of the combination of the patent in suit.

Secondly, as pointed out in Evans' main brief, pages 60-62, the travelling beam crane art upon which Preco relies so heavily is a non-analogous art, but even if properly entitled to consideration, contains no disclosure or suggestion of a pivotal connection between the trolley and the hoist supported thereby and there is no suggestion in the bulkhead art prior to the patent in suit, of a bulkhead connected by a pivotal connection to a trolley moveable along a transverse beam mounted for movement longitudinally of the car.

B. The Contention that the Structure of the Wells Patent in Suit Has Never Been Produced and Is Not Suitable for Use In a Freight Car

This contention at pages 16-18 and 56-57 of Preco's brief appears primarily to relate to the specific construction illustrated in the Wells patent and insofar as that is the case, this contention is clearly irrelevant. The construction illustrated in the Wells patent is admittedly designed for use in a cattle truck and one skilled in this art would naturally use a specifically different construction in a railroad boxcar which is over nine feet wide, over ten feet tall, and where the freight bracing forces are many times those encountered in cattle trucks both because the railroad cars carry many times the freight load of the pickup truck and because of the severe shock loads encountered by the railroad cars. The contention, even if true, that the specific structure illustrated in the Wells patent has never

been produced in no way weakens the Wells patent in view of the fact that other embodiments of the Wells invention have been produced in large numbers and met with commercial success.

Wells et al. clearly contemplated that their invention was usable in railroad cars and so stated in the opening paragraph of their patent. The fact that the inventors chose to illustrate in their patent an embodiment in a truck for transporting cattle in no way weakens the right to enforce the patent against one using the invention in a railroad car in accordance with the patentees' suggestion that it could be so used.

Similarly, the facts that the embodiments of the Wells invention produced by Evans were for use in railroad cars, that Evans never constructed the specific structure illustrated in the Wells patent, and that Evans had no knowledge regarding the first successful testing and use of the Wells invention, have no bearing on the validity of the Wells et al. patent.

CONCLUSION

Appellant Evans respectfully submits that the judgment should be reversed.

Respectfully submitted,

HARNESS, DICKEY & PIERCE,
By: John A. Blair,
Robert L. Boynton,

LYON & LYON,
By: Roland N. Smoot.

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

................................,

Robert L. Boynton,
Attorney.

PROOF OF SERVICE

Robert L. Boynton, counsel for Appellant, Evans Products Company, in the above entitled matter hereby certifies that three (3) copies of the foregoing Brief were placed in the United States mail, air mail, special delivery with postage fully prepaid addressed to Whann & McManigal, 315 West Ninth Street, Los Angeles, California, 90015, on this 21st day of December, 1966.

Robert L. Boynton.